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THE SOUTH DAKOTA LOOPHOLE

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE

OF THE

COMMITTEE ON
BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

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THE SOUTH DAKOTA LOOPHOLE

WEDNESDAY, SEPTEMBER 11, 1985

House of Representatives,
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance,
Committee on Banking, Finance and Urban Affairs,
Washington, DC.

The subcommittee met, pursuant to call, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Fernand J. St Germain (chairman of the subcommittee) presiding.

Present: Chairman St Germain; Representatives Barnard, LaFalce, Lehman, Cooper, Roemer, Gordon, Wylie, McKinney, Shumway, McCollum, Parris, Roukema, and Bereuter.

Chairman St Germain. The subcommittee will come to order.

This afternoon the subcommittee will conduct a hearing which will focus on what has been commonly referred to within the last couple of years as the South Dakota loophole. Recent efforts on the part of Citicorp and others to export new insurance activities granted to State-chartered South Dakota banks, and which are otherwise impermissible under the Bank Holding Company Act, have given the House Banking Committee some concern.

Although the recent Fed decision which denied Citicorp's application to acquire a State-chartered bank in South Dakota for such purposes is encouraging, the South Dakota loophole, nevertheless, is an issue which must be, and I feel should be, addressed by the Congress. It is the prerogative, and indeed the responsibility of the Congress to define and develop a rational policy in this area of banking law.

At this point we will insert the opening statement of the ranking minority member of the subcommittee, Congressman Chalmers P. Wylie.

[The opening statement of Hon. Chalmers P. Wylie follows:]

HON. CHALMERS P. WYLIE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
"SOUTH DAKOTA LOOPHOLE" HEARINGS
SEPTEMBER 11, 1985

MR. CHAIRMAN:

I WISH TO EXTEND MY THANKS TO YOU FOR PUTTING THE TOPIC OF THE SO-CALLED "SOUTH DAKOTA LOOPHOLE" ON THE SUBCOMMITTEE'S HEARING AGENDA. IN ADDITION TO WELCOMING OUR DISTINGUISHED PANEL, I WOULD LIKE TO MAKE SEVERAL POINTS ABOUT THE TOPIC BEFORE US TODAY.

FIRST, IN MANY REPECTS WE ARE FACING A "GENERIC" PROBLEM HERE. THE ISSUE IS NOT WHETHER A BANK SHOULD BE ALLOWED TO ENGAGE IN A PARTICULAR ACTIVITY. THE ISSUE IS: SHOULD STATES ALLOW THEIR STATE CHARTERED INSTITUTIONS TO CARRY ON ACTIVITIES OUT OF STATE, WHICH ARE IMPERMISSIBLE WITHIN THE STATE? DO SUCH STATE LEGISLATIVE INITIATIVES, OBVIOUSLY ARISING FROM COMPETITIVE PRESSURES, CAUSE FURTHER FRAGMENTATION OF THE FINANCIAL SYSTEM BY IMPOSING RISKS UNACCEPTABLE ON A NATIONAL SCALE? I KNOW THAT THESE ARE RHETORICAL QUESTIONS, BUT THEY ARE THE QUESTIONS THAT WE MUST ANSWER IN ORDER TO GRAPPLE WITH THE DILEMMA AT HAND THIS AFTERNOON.

FEDERAL RESERVE BOARD CHAIRMAN PAUL VOLCKER ADDRESSED THIS ISSUE IN HIS TESTIMONY BEFORE THE SENATE BANKING COMMITTEE IN MARCH OF LAST YEAR. IN HIS STATEMENT, CHAIRMAN VOLCKER SAID:

> THE STATES ARE MOTIVATED IN PART BY A DESIRE TO MAKE THEIR FINANCIAL INSTITUTIONS COMPETITIVE WITH THOSE IN OTHER STATES AND IN PART BY A DESIRE TO OBTAIN NEW EMPLOYMENT AND REVENUES -- INEVITABLY AT THE EXPENSE OF OTHERS. AS THE PROCESS GAINS MOMENTUM, MORE AND MORE STATES WILL FEEL THEMSELVES FORCED, IN SELF-DEFENSE, TO TAKE SIMILAR STEPS. THE THREAT IS OBVIOUS -- ANY SENSE OF CONGRESSIONAL OR FEDERAL CONTROL OVER THE EVOLUTION OF THE BANKING AND FINANCIAL SYSTEM WILL BE LOST.

THE SECOND POINT I WOULD LIKE TO MAKE DEALS WITH THE SAFETY AND SOUNDESS ISSUE. THIS HEARING COULD NOT BE MORE TIMELY AS IT FOLLOWS THE BEGINNING OF A SERIES OF HEARINGS IN THIS SUBCOMMITTEE ON THE STATE OF THE FINANCIAL SERVICES INDUSTRY AND THE DEPOSIT INSURANCE SYSTEM. THE STATES ARE IN THE BEST POSITION TO MAKE JUDGMENTS ABOUT WHAT IS NECESSARY TO PROTECT LOCAL CUSTOMERS AND LOCAL INTERESTS. IN ADDITION, WE STILL WANT TO MAINTAIN FLEXIBILITY FOR STATE EXPERIMENTATION AND INNOVATION. BUT ON THE OTHER HAND, I BELIEVE THIS EXPERIMENTATION MUST BE WITHIN CERTAIN GUIDELINES AS LONG AS OUR FEDERAL SAFETY NET IS AT RISK. IN THE FINAL ANALYSIS, THE SAFETY AND SOUNDNESS OF OUR BANKING SYSTEM IS A MATTER OF NATIONAL INTEREST WHICH CANNOT BE LEFT ENTIRELY TO THE STATES.

IN LEGISLATION I INTRODUCED LAST JANUARY, H.R. 15, I ADDRESSED THE PROBLEM OF STATE LAWS WHICH PERMIT INSTITUTIONS TO EVADE FEDERAL POLICIES. MY BILL ACTS IN A NARROW MANNER, ONLY AFFECTING THOSE STATE PROVISIONS WHICH CAN BE SHOWN TO BE DESIGNED TO EVADE A FEDERAL STATUTE OR WHICH ADVERSELY AFFECT NATIONAL INTERESTS. THUS, SECTION 205 OF MY BILL RECOGNIZES THE RIGHTS OF THE STATES TO LEGISLATE FOR THEIR OWN INSTITUTIONS AND TO REGULATE THEIR ACTIVITIES WITHIN THEIR OWN BOUNDARIES, ON THE CONDITION THAT SUCH ACTIVITIES DO NOT DIRECTLY THREATEN THE SAFETY AND SOUNDNESS OF THE BANKING SYSTEM OR DEROGATE FEDERAL LAW. I MIGHT ADD THAT THE FEDERAL RESERVE IS GENERALLY SUPPORTIVE OF MY APPROACH ACCORDING TO A LETTER I RECEIVED FROM CHAIRMAN VOLCKER LAST MAY.

FINALLY, I WOULD LIKE TO APPLAUD THE FEDERAL RESERVE BOARD IN THEIR DECISION TO DENY CITICORP'S APPLICATION TO TAKE ADVANTAGE OF

THE SOUTH DAKOTA LOOPHOLE AND ACQUIRE A BANK IN SOUTH DAKOTA IN ORDER TO ENGAGE IN INSURANCE ACTIVITIES. THE BOARD'S DECISION TO DENY THE CITICORP APPLICATION WAS BASED ON THE UNIQUE CIRCUMSTANCES PRESENTED BY THE SOUTH DAKOTA LEGISLATION. IT WAS OBVIOUS TO THE BOARD THAT CITICORP WAS PRIMARILY ACQUIRING THE BANK IN ORDER TO ENGAGE IN NONBANKING ACTIVITIES OUTSIDE OF SOUTH DAKOTA. THE ACTIONS OF THE SOUTH DAKOTA STATE LEGISLATURE ARE INCONSISTENT WITH THE COMPREHENSIVE FEDERAL FRAMEWORK FOR REGULATING THE CONDUCT OF NONBANKING ACTIVITIES BY BANKING ORGANIZATIONS. AGAIN, WE ARE BACK TO THE "GENERIC" DILEMMA THIS ISSUE POSES. THE STATE ACTED WITHOUT TAKING INTO CONSIDERATION THE NATIONAL ISSUES AT STAKE.

I THANK THE WITNESSES FOR JOINING US THIS AFTERNOON AND AM EAGER TO HEAR THEIR TESTIMONY.

Chairman St Germain. Our first witness this afternoon is Hon. J. Charles Partee, Member, Board of Governors of the Federal Reserve System. Governor Partee, we will put your statement in the record, and you may proceed.

STATEMENT OF HON. J. CHARLES PARTEE, MEMBER, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Partee. Thank you, Mr. Chairman, Mr. Wylie.

I am pleased to appear before the subcommittee today to present the Board's views on the so-called South Dakota loophole. This loophole, which is based on a recent South Dakota law authorizing out-of-State bank holding companies to acquire State-chartered banks in South Dakota and to engage through these banks in all facets of the insurance business primarily outside of the State, conflicts with prevailing Federal law and regulation. Indeed, there has been a proliferation in recent years of State laws authorizing federally insured banks and thrifts to engage in a broad range of nonbanking activities not previously deemed appropriate for depository institutions, including securities and real estate investment and development activities as well as insurance sales and underwriting.

The proliferation of State laws authorizing new non-banking activities appears to have developed in part in response to pressures from banking institutions that have turned to State law as a means of engaging in new nonbanking activities foreclosed to them by Federal law. The States enacting these laws, in turn, are motivated in many cases by a desire to attract new employment and revenues by offering bank holding companies a means of exploiting ambiguities or loopholes in Federal law. There is no gain in this for the economy as a whole and there could well be heavy costs to bear for the Federal Government and for the users of the financial system.

The legislation in South Dakota stands out as an example of State efforts to expand jobs and revenues at the expense of other considerations. The preamble to the South Dakota statute indicates that its purpose is to secure new employment and revenue for the State by enabling out-of-State bank holding companies to take advantage of a "unique opportunity" afforded by perceived loopholes in the national banking laws. South Dakota has, however, insulated its own domestic financial and insurance institutions against the competitive and other effects of these activities by specifically providing that a new South Dakota bank acquired by an out-of-State holding company must conduct its banking and insurance activities at a location and in a manner so as not to attract customers from the general public to the detriment of existing banks or insurance companies in the State. South Dakota, thus, has authorized its banks to engage, in every State other than South Dakota, in activities expressly prohibited under Federal law and, indeed, under many State laws.

The Board's main concern with statutes such as this is that they are not appropriately balanced by considerations relating to the safety and soundness of the Nation's banking system. We recognize, of course, the interest of the States in regulating banking within their borders. Nevertheless, serious questions must be raised about an undermining of the carefully established Federal framework of authorized nonbanking powers for banks and thrifts through the actions of individual States, motivated not by concerns for safety and soundness, but by other parochial objectives. In view of the powers expansion in South Dakota and other States and the likelihood that this example could well be emulated elsewhere, we believe that Congress should enact legislation on banking and thrift powers that reconciles the States' legitimate need for flexibility with the Federal Government's concern about the problems of excessive risks for the banking and thrift system and the Federal financial safety net.

H.R. 1513 goes some distance toward dealing with the dangers posed by the broad State-authorized activities for banking and thrift organizations. The bill is based on the premise that a State should not be able to insulate itself from the competitive and other effects of wide ranging and potentially damaging nonbanking activities that it authorizes for institutions it charters but which operate predominantly in other States.

In view of the proliferation of State laws authorizing extensive securities, insurance, equity investment and real estate activities, however, and the increased risks these activities pose for the Federal safety net and the Nation's banking system, the Board strongly believes that the limitations contained in H.R. 1512 should be expanded to cover activities even when conducted within the authorizing State if it is determined that they threaten safety and soundness. As I have stressed, it is not desirable, even within their own borders, for States to expose the banking system to the increased risks of nonbanking activities that Congress has determined are unsafe and unsound for Federal institutions and bank holding companies.

It does seem desirable, however, to allow the States to retain flexibility to experiment with new initiatives in local banking and thrift services by authorizing nonbanking activities within State borders if such activities are not determined to be unsafe or unsound. For example, many State banks have operated insurance agencies and travel bureaus pursuant to State law for many years. These activities do not pose threats to the stability of the banking system since the risks associated with such activities are rather minimal.

We thus would favor retaining flexibility to allow the States to continue to authorize such activities. A provision such as in section 2 of H.R. 1513 that would apply all of the title VI insurance prohibitions to subsidiary banks of bank holding companies is undesirable because it would limit the procompetitive aspect of insurance sales activities by banks. The Board has previously testified in favor of an appropriate expansion of bank holding company powers to accommodate the evolution of the financial services industry, and we would prefer to see a legislative solution along the lines of H.R. 1513 that still allows flexibility in this area, but with authority to limit risks that cause safety and soundness concerns.

Thank you very much, Mr. Chairman.

[The prepared statement of Governor Partee follows:]

For release on delivery
2 p.m., E.D.T.
September 11, 1985

Statement by

J. Charles Partee

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions Supervision,
Regulation and Insurance

United States House of Representatives

September 11, 1985

I am pleased to appear before the Subcommittee today to present the Board's views on the so-called South Dakota loophole. This loophole, which is based on a recent South Dakota law authorizing out-of-state bank holding companies to acquire state chartered banks in South Dakota and to engage through these banks in all facets of the insurance business primarily outside of the state, conflicts with prevailing federal law and regulation. Indeed, there has been a proliferation in recent years of state laws authorizing federally insured banks and thrifts to engage in a broad range of nonbanking activities not previously deemed appropriate for depository institutions, including securities and real estate investment and development activities as well as insurance sales and underwriting.

This trend is of special concern because certain of these state laws do not appear to be motivated in any substantial measure by considerations relating to improving the banking or thrift structure or by any local need for the services authorized, but rather by a desire to attract new business and tax revenues to the states through the liberal use of a bank franchise.

A competitive race among the states to expand nonbanking powers would substantially increase the level of risk in the banking system. For example, the recently enacted Ohio law allows a state bank to invest as much as

50 percent of its assets in real estate. An Ohio bank could thus effectively transform itself from a banking institution into a real estate investment company of the type and with the potential for the problems that have occurred in Maryland recently. The same is true for the statutes that permit investment in equity securities. Similarly, so-called wildcard statutes or leeway provisions authorize investment of substantial amounts of banking assets in any activity not otherwise prohibited, thus allowing state banks to invest in nonbanking ventures of every type and description.

Congress has not authorized these activities for national banks or bank holding companies and indeed has specifically banned many of them as unsafe and unsound. The Glass-Steagall Act, for example, prohibits national banks and state member banks from engaging in, or being affiliated with a company engaged principally in, dealing or underwriting most types of securities. Title VI of the Garn-St Germain Depository Institutions Deregulation Act of 1982 prohibits bank holding companies from underwriting insurance. Real estate development activities are not permissible for national banks and have not been determined by the Federal Reserve to be closely related to banking and thus permissible for bank holding companies.

The proliferation of state laws authorizing new nonbanking activities appears to have developed in part in response to pressures from banking institutions that have turned to state law as a means of engaging in new nonbanking activities foreclosed to them by federal law. The states enacting these laws in turn are motivated in many cases by a desire to attract new employment and revenues by offering bank holding companies a means of exploiting ambiguities or "loopholes" in federal law. There is no gain in this for the economy as a whole and there could well be heavy costs to bear for the federal government and for the users of the financial system.

The legislation in South Dakota stands out as an example of state efforts to expand jobs and revenues at the expense of other considerations. The preamble to the South Dakota statute indicates that its purpose is to secure new employment and revenue for the state by enabling out-of-state bank holding companies to take advantage of a "unique opportunity" afforded by perceived loopholes in the national banking laws. South Dakota has, however, insulated its own domestic financial and insurance institutions against the competitive and other effects of these activities by specifically providing that a new South Dakota bank acquired by an out-of-state holding company must conduct its banking and insurance activities at a location and in a manner so as not to attract customers from the general public to the detriment of existing banks or insurance companies in the state. South Dakota thus has authorized its banks to engage, in every state other than South Dakota, in activities expressly prohibited under federal law and indeed under many state laws.

The Board's main concern with statutes such as this is that they are not appropriately balanced by considerations relating to the safety and soundness of the nation's banking system. We recognize, of course, the interest of the states in regulating banking within their borders. The dual banking system has contributed on balance to the flexibility and resiliency of our banking system, and has helped make it more responsive to the needs of both business and consumers. Nevertheless, serious questions must be raised about an undermining of the carefully established federal framework of authorized nonbanking powers for banks and thrifts through the actions of individual states, motivated not by concerns for safety and soundness, but by other parochial objectives. In view of the powers expansion in South Dakota and other states and the likelihood that this example could well be emulated elsewhere, we believe that Congress should enact legislation on banking and thrift powers that reconciles the states' legitimate need for flexibility with the federal government's concern about the problems of excessive risks for the banking and thrift system and the federal financial safety net.

The new state laws, and the South Dakota statute in particular, are premised in great part on lack of clarity in the Bank Holding Company Act as to its application to the direct activities of subsidiary banks of bank holding companies. The Act embodies the national policy against the commingling of banking and commerce by precluding bank holding companies from engaging in or acquiring companies engaged in activities that are not closely related to banking. The Board has long held that the provisions of the Act apply to acquisitions by holding company banks of voting shares of a nonbanking company. In 1971, with the expansion of the Act to cover one bank holding companies, the Board adopted a regulatory provision that allows wholly owned operating subsidiaries of bank holding company banks to engage in activities that the bank itself may engage in directly pursuant to state law. This provision was adopted to promote competitive equity between holding company banks and independent banks in the absence of evidence of abuse or evasion by bank holding companies of the nonbanking provisions of the Act.

In adopting this regulation, however, the Board expressly noted that a potential conflict could arise between the nonbanking restrictions of the Act and state law if state law was interpreted to permit nonbanking activities that were impermissible for a bank holding company under the Act. In a statement issued with the regulation, the Board specifically noted that it would review the provision from time to time to ensure that it was not being used to frustrate the Act's purposes.

Since 1971, holding company banks, relying on this regulatory provision, have engaged in a limited variety of nonbanking activities authorized by state law, for example, insurance agency and travel agency activities. Until the South Dakota statute, the Board did not feel that there had been significant abuse of this provision. State authorized activities generally had been of a limited nature, had not been authorized on a large scale, had generally been conducted in-state without the types of operating limitations in the South Dakota law, and, most importantly, had not posed significant risks to the banking system.

The application by Citicorp to acquire a South Dakota state bank for the purpose of engaging in broad insurance activities pursuant to the South Dakota law, in the Board's view, was inconsistent with the regulatory provision adopted by the Board in 1971. Citicorp's application, and the prospect of numerous similar applications as other states enacted new nonbanking powers for state banks, carried the potential for widespread evasion of the Bank Holding Company Act. Accordingly, the Board in January 1984 suspended processing of the application, as well as similar applications filed by BankAmerica Corporation and First Interstate Bancorp, noting its tentative judgment that it could not approve the proposals in view of existing law and expressions of Congressional intent. After Citicorp reactivated its application, the Board proceeded to reach a final decision on the case and denied the application as a circumvention of the provisions in the Bank Holding Company Act which sharply limit the scope of bank holding company insurance activities. The Board concluded that the overall effect of the South Dakota law on the proposed nationwide insurance activities of the state bank to be acquired by Citicorp would be that the bank would act as an insurance company in direct contravention of the Act's restrictions.

While the Board believes that it has authority under the Act to regulate the activities of nonbanking subsidiaries of bank holding companies, the additional question of whether the nonbanking restrictions of the Act apply to activities engaged in directly by a subsidiary bank has been raised in a number of contexts, including petitions to the Board and litigation. The Board has under consideration this question, as well as whether to revise its existing regulatory provision for operating subsidiaries of holding company banks.

In recognition of the serious risks posed by the expansion of nonbanking powers of state banks and thrifts, both the Federal Deposit Insurance Corporation and the Federal Home Loan Bank Board have undertaken regulatory initiatives that would set limits on the scope of nonbanking powers authorized by state law. The FDIC has proposed to establish operating and investment limitations on certain nonbanking activities of FDIC insured banks. The FHLBB has promulgated regulations that would establish a review procedure by the Federal Home Loan Banks on a case-by-case basis for direct investment by thrifts in certain nonbanking activities over a threshold amount.

Notwithstanding these actions, we would concur in the view that legislation is needed to provide a uniform national policy with respect to the proper scope of state authorized nonbanking activities consistent with a safe and sound financial structure. H.R. 1513 addresses the problem of South Dakota type statutes by limiting the ability of state banks to engage in activities not permissible for national banks or bank holding companies outside of the authorizing state. Similarly, savings and loan associations and savings banks would be prohibited from engaging outside of the authorizing state in activities not permissible for federal thrifts or multiple savings and loan holding companies. In addition, the bill applies the prohibitions on bank holding company insurance activities enacted in Title VI of the Garn-St Germain Depository Institutions Deregulation Act to bank subsidiaries of bank holding companies.

H.R. 1513 goes some distance toward dealing with the dangers posed by the broad state authorized activities for banking and thrift organizations. The bill is based on the premise that a state should not be able to insulate itself from the competitive and other effects of wide ranging and potentially damaging nonbanking activities that it authorizes for institutions it charters but which operate predominantly in other states.

In view of the proliferation of state laws authorizing extensive securities, insurance, equity investment and real estate activities, however, and the increased risks these activities pose for the federal safety net and the nation's banking system, the Board strongly believes that the limitations contained in H.R. 1513 should be expanded to cover activities even when conducted within the authorizing state if it is determined that they threaten safety and soundness. As I have stressed, it is not desirable, even within their own borders, for states to expose the banking system to the increased risks of nonbanking activities that Congress has determined are unsafe and unsound for federal institutions and bank holding companies.

It does seem desirable, however, to allow the states to retain flexibility to experiment with new initiatives in local banking and thrift services by authorizing nonbanking activities within state borders if such activities are not determined to be unsafe or unsound. For example, many state banks have operated insurance agencies and travel bureaus pursuant to state law for many years. These activities do not pose threats to the stability of the banking system since the risks associated with such activities are rather minimal. Indeed, Congress has allowed savings and loan holding companies to own and operate insurance agencies for many years and federal savings and loan associations also are permitted to operate insurance agencies through service corporations. National banks similarly have been authorized to operate insurance agencies in small localities.

We thus would favor retaining flexibility to allow the states to continue to authorize such activities. A provision such as in section 2 of H.R. 1513 that would apply all of the Title VI insurance prohibitions to subsidiary banks of bank holding companies is undesirable because it would limit the procompetitive aspect of insurance sales activities by banks. The Board has previously testified in favor of an appropriate expansion of bank holding company powers to accommodate the evolution of the financial services industry, and we would prefer to see a legislative solution along the lines of H.R. 1513 that still allows flexibility in this area, but with authority to limit risks that cause safety and soundness concerns.

Chairman St Germain. The Chair wishes to apologize to Mr. Wylie. He did have an opening statement, and I recognize Mr. Wylie at this time.

Mr. Wylie. Thank you very much, Mr. Chairman.

I appreciate the thought and the fact that it was just an oversight. I would ask unanimous consent to insert my opening statement right after yours in the record?

Chairman St Germain. Is there an objection? The Chair hears none.

Mr. Wylie. I again want to compliment you for putting this topic of the so-called South Dakota loophole on the subcommittee's agenda and providing this opportunity to hear some very distinguished witnesses talk about the issue.

In my statement I suggested, I think we have more of a generic problem here today, and that is what are the activities which State legislatures should be allowed to engage in vis-a-vis the national interest?

The second point that I would make on that is that in the final analysis, we have to concern ourselves with the safety and soundness of the banking system as a matter of national interest, and in some cases those decisions cannot be left with the States, and then I would refer to my own legislation, H.R. 15, in which I address this problem, and I would ask of Mr. Partee a little later on about what he thinks of a provision in my bill.

We are all trying to do everything we can to be constructive in this area and other areas of banking legislation. So I have given it some thought and put some language in this bill and would ask for comment on that.

Mr. Chairman, thank you very much.

Chairman St Germain. Thank you, Mr. Wylie.

Governor Partee, on page 7 and 8 of your testimony you state, and I quote: "The additional question of whether the non-banking restrictions to the act apply to activities engaged in directly by a subsidiary bank has been raised in a number of contexts, including petitions to the Board and litigation."

Was this one of the issues in the Board's recent decision denying the Citicorp application? Would you explain this for us, or elaborate on it?

Mr. Partee. Well, the Citicorp—this is a highly legal matter, but the Citicorp application was considered in light of the particular circumstances of the intent of Citicorp, as expressed by them to us, and of the way the bank would be organized. We felt that in view of the fact that Citicorp was going to do a nationwide insurance business in volume far exceeding anything planned in banking services for the State bank that they were acquiring in South Dakota that we could find, looking at the whole matter, that what they were proposing represented an evasion of the Federal law, section 4 of the Bank Holding Company Act.

We didn't find directly on the question of whether we have the authority to control the activities conducted by State banks owned by bank holding companies, which is, as I understand, a controversial legal question. Nor did we in this case determine that we could control the activities engaged in by a subsidiary of a bank that is owned by a holding company, though we certainly feel we have the authority to do that.

So we are hitting this thing piece by piece in the legal area, Mr. Chairman, and it seems inefficient. We would rather have the Congress tell us what they clearly meant, which is that the banks aren't supposed to do this kind of thing.

Chairman **St Germain**. We will try to give very serious thought to your suggestion.

Mr. **Partee**. If you don't happen to get it through, let me assure you we will do everything we can to stop activities of this kind.

Chairman **St Germain**. By the way, the decision by the Board is appealable; is it not?

Mr. **Partee**. Yes, I believe so. Mr. Mattingly says the time periods have run without an appeal being filed.

Chairman **St Germain**. But it could have been appealed?

Mr. **Partee**. Right.

Chairman **St Germain**. Mr. Barnard.

Mr. **Barnard**. Welcome, Governor Partee, to the subcommittee. I just have one question as to the Fed's position on insurance in general.

In your testimony, you indicated that the Fed did agree on some expansion of powers for bank holding companies. Do these include some insurance powers, Governor Partee?

Mr. **Partee**. Yes. We would, and have in fact, testified before Congress in favor of permitting banks to engage in insurance agency activities, that is sales activities, and we would not oppose bank holding companies having separate affiliates that engage in underwriting insurance under prudential limitations, and we have so testified in the Senate in connection with the Garn bill.

Mr. **Barnard**. Thank you.

Chairman **St Germain**. Mr. Wylie.

Mr. **Wylie**. Thank you, Mr. Chairman.

Mr. Partee, as I see it, we have a difficult issue here, and I said something about it in my opening statement. Should States be allowed through their State-chartered institutions to carry on activities out of the State which would be impermissible within the State? That is an issue which I think we have to address.

I have introduced legislation earlier this year in which I said the answer to that is no. What would be your judgment on that?

Mr. **Partee**. I think that is particularly egregious. As I understand it, that is what H.R. 1513 was addressing, and I think the worst of all worlds is where they become, you might say, an offshore banking center on shore, which is what they have intended to do.

Mr. **Wylie**. And I would assume that States do have that authority unless we act otherwise.

Mr. **Partee**. Unless we can find legal ways to stop them within our regulatory authority, yes.

Mr. **Wylie**. Now, if we were to apply new restrictions on the insurance powers of bank holding companies, shouldn't we also apply those same restrictions across the board to other financial institutions?

Mr. **Partee**. Well, we would think that there should be very similar kinds of requirements for the direct competitors of banks, with thrift institutions certainly. I think it would have to be looked at on a case-by-case basis, but I see no reason for permitting savings and loans and savings and loan holding companies and service corporation subsidiaries of savings and loans offering insurance all over the place and then preventing banks from doing the same thing. It seems to me inconsistent.

Mr. **WYLIE**. Thank you very much. Thank you, Mr. Chairman.

Chairman **ST GERMAIN**. Mr. LaFalce.

Mr. **LAFALCE**. No questions, Mr. Chairman.

Chairman **ST GERMAIN**. Mr. Lehman.

Mr. **LEHMAN**. Getting back to the chairman's question, Mr. Partee, you say that the Fed's decision with respect to the Citicorp application to peddle insurance through South Dakota is not the final answer to that issue because it was limited to that one case, because it only addressed the scope of the plan that Citicorp had?

Mr. **PARTEE**. That is my understanding. In this particular case, we could regard this as being a direct evasion of Federal law because of the planned activity. Let's say, for example, that a similar application were received, but one in which there was going to be a substantial amount of banking activity in addition to the insurance underwriting, it might be a closer call. I think—you see, sir, I am not a lawyer, but it seems to me—in every one of these decisions, that there is a line some place, and if we are close to the line we will be challenged in court and perhaps lose.

Since it seemed to us the obviously clear intent of Congress to do what we in fact did in this case, it would be nice to avoid all that potential for litigious activity with individual applications as we receive them.

Mr. **LEHMAN**. So, in other words, schemes to be designed that the Board might feel it didn't have the power to——

Mr. **PARTEE**. I wouldn't like to admit that. We will do our very best to find something illegal about any scheme given to us, but there are gradations, of course.

Mr. **LEHMAN**. What about the question of equity Mr. Wylie brings up? We are dealing with this bill with one limited situation, one loophole. At the same time, if we pass this bill under existing law, Sears, Penneys, and Wards will be able to peddle financial services, real estate, and insurance nationwide.

Do you think it is right or good policy to single out this one incidence of abuse?

Mr. **PARTEE**. Sears and Wards and so forth are not depository institutions, at least not for the most part. They sometimes have some depository taking activities that somehow have crept in through other loopholes, but that is not their principal business.

The point I wish to make is that we don't think that, in an effort to get competitive equity, we should allow our banking system to be undermined and safety and soundness to be threatened. You can't, by seeking the lowest common denominator in all cases, end up with a desirable result, and so without speaking to Sears and Montgomery Ward and whether they ought to be doing these things, I don't think that we would want the banks or, if I might say so, just in a general way, the thrifts to be engaged in an underwriting activity without careful safeguards. And there is no basis for careful safeguards in the South Dakota law.

Mr. **Lehman**. Thank you, Mr. Chairman.

Chairman **St Germain**. Mr. McKinney.

Mr. **McKinney**. Thank you, Mr. Chairman.

Governor Partee, it is a delight to see you again. You still have the same clever turn of phrases. Basically, we have little disagreement on anything, so I am going to give an opening statement with you. However, we are going to get to one disagreement at the end.

I am fascinated by the new financial concept that if your bank isn't making enough money, it is because it doesn't have equity, and it is because you don't have some other line of business to dash off into. It is as if you can't run the bank right, let's find something else and do it instead. You know, as a Connecticut resident seeing some of my friends out there I would tell everyone in the audience to get it clear in the record; nobody that works in the insurance business in Connecticut lives in my district unless they are a broker. It is amazing, I watched Hartford, I watched Aetna Casualty, I watched a few others, and it seems to me the common expression for them is "bleeding to death."

We now see municipal underwriting being canceled. We are having big questions with space shots, we are beginning to wonder about pharmaceutical companies because at the bottom of the line with the litigative society we live in, there is blood. I can't understand why banks, who are in a risky enough business vis-a-vis Brazil, Zaire, et cetera, feel that suddenly there is a pot of gold at the end of the rainbow because they are going to get into the next riskiest business, which is called underwriting.

On top of that, I then would have to state I see very little difference between Citicorp being nationwide and Citicorp in the insurance business being New York statewide. I think it is very interesting that my chairman and good friend, Mr. St Germain, from Rhode Island, had us sitting here this morning listening to the dangers facing FSLIC and FDIC. Why? Because, in fact, S&L's and thrifts in the main were dashing off into areas where they had no expertise and where they have jeopardized through the holding company or through the bank itself their financial surety, and guess who is going to pay the bill? The U.S. taxpayer.

If we move on from that to the point where we saved the bank holding company at Continental Illinois and by saving the holding company, we have a mess. I would totally agree with you, that when banks are showing a clear profit doing what they are supposed to do, then perhaps you can talk about something else. But then you run into the one point where I would like to have your comment.

Captivity—Brave is the man, unless he is chairman of the board, who walks into a bank and thinks he is going to control the loan portfolio. Brave is the man, even after 20 years on the Banking Committee who walks in to get a mortgage, and thinks he is going to be in charge. How do you at the Fed feel about the fact that if you are asking for money, despite the collateral you might have, you are in fact a petitioner?

Along with most loans go things like life insurance policies, home insurance policies, casualty policies, et cetera. How can we possibly turn around and say that the purveyors of money can have the power also to sell insurance without subjecting people to undue pressure and undue captivity?

Mr. PARTEE. Mr. McKinney, the question of tie-in sales has been one of long concern to the Congress. It is prohibited in truth in lending and is a basis, as a matter of fact, for an action against the bank or the lender. We and the other agencies have assessed substantial fines for violations of the prohibition on requiring insurance from the lender in connection with consumer loans.

Further, we have looked quite carefully at the evidence, have done surveys, and have followed complaint files, and we can't find any evidence that tie-ins—that is compulsory tie-ins—of insurance business have been a serious problem with regard to the extension of bank credit.

I understand as a matter of gut instinct what you are saying. I must say I have never agreed to any insurance from the lender in connection with a bank loan, and I never would as a matter of principle, even if I thought it was a good deal.

Mr. McKINNEY. But you are a Governor of the Federal Reserve Board. That is a far different cry.

Mr. PARTEE. I don't think my bank knows I am a Governor of the Federal Reserve Board.

Mr. McKINNEY. Neither side is insurance innocent. While I don't want banks to sell insurance, which is rather obvious, I would turn around to my independent insurance agent, as I did in the chairman's own district when I spoke in Newport, and say "You guys can't rent space in bank office lobbies either." It works both ways.

But there is no law that has ever been proven against the power of suggestion. "We will contemplate your loan, we will let you know in 3 days, now let us find out about your financial stability and your insurance coverage."

Chairman ST GERMAIN. All kidding aside, with all this focus about tie-in sales being prohibited it is like questioning someone's intent, Governor Partee, in law.

One of the most difficult things there is is intent. Nine-tenths of the time, the jury comes down with the wrong verdict on what the intent was, not because they do so intentionally, but because it is so difficult.

From the great State of Tennessee, Mr. Cooper.

Mr. COOPER. I have no questions, Mr. Chairman.

Thank you.

Chairman ST GERMAIN. And from northern Louisiana, Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman.

Thank you for your testimony. Let me make sure I understand it. You are opposed to the South Dakota loophole and would like it closed.

Mr. PARTEE. Right.

Mr. ROEMER. You don't think we ought to go as far as the DOT approach on the Senate side, which erected Glass-Steagall prohibitions across banking institutions regardless of their charters, as I understand they prohibited State action in that regard.

You would not go that far?

Mr. **Partee**. I don't think that is necessary. In this particular bill, section 2 prohibits it for banks, as I read it, except for the grandfathered banks. I don't see any necessity for going that far.

I would take section 3, which says you must do it in the State if it is not authorized by Federal law, and I would extend to that, however, a qualification that if it creates a safety and soundness concern, the activity can be limited or prohibited.

Mr. **Roemer**. Let me see if I get your priorities straight, and I don't want to misquote you. You would close the South Dakota loophole, particularly in regard to chartering of State "A" activities and any other lettered States.

That would be out.

Mr. **Partee**. Yes.

Mr. **Roemer**. You would have the prohibition of Glass-Steagall reinforced vis-a-vis subsidiaries and all the rest. You would not prohibit State action within State borders of insurance activities as long as the issue of safety and soundness were addressed and protected.

Do I misstate your position?

Mr. **Partee**. No, that is correct.

Mr. **Roemer**. All right. If that is true, give it to me again, the benefits of one set of rules in our national view and another set of rules in our local view.

And I am not—you know, I am not trying to put you in any box, I would like you to take your expertise to that limited question as to what we gain.

I am sure there is some things we gain. Explain them to me.

Mr. **Partee**. I think the philosophical argument is that we do not have all of the wisdom here in Washington, and there could be good ideas out in the countryside as well. The States' rights issue, the dual banking issue, is precisely that if we permit States to do things that they think are right for their people, we might find some very good activities that could be adopted nationally as a result of this.

The disturbing aspect about South Dakota is that they have authorized an activity which they don't think is good for their people, because they prohibit it within the State of South Dakota. But that is the argument for a dual banking system, and that is the argument for this.

And I must say, I find it rather convincing. So long as they don't jeopardize the financial system with such activities.

Mr. **Roemer**. I find it convincing also. I thank you for stating it.

Chairman **St Germain**. Mr. Gordon from the great State of Tennessee.

Mr. **Gordon**. I yield my time to my colleague from Georgia.

Mr. **Barnard**. Thank you, Mr. Gordon. I appreciate that very much. I just feel the necessity to respond to my good friend and colleague and one who I generally agree with from Congress, but on this occasion——

Chairman **St Germain**. Excuse me, am I monitoring a debate here?

Mr. **Barnard**. No—that was my point. I think that his points could be debated at great length, but of course, that is not the occasion of this hearing this morning, but I would have to remind him that in this morning's testimony, none of the regulators indicated that the activities outside of just banking was causing the breaking of any of these banks.

They particularly said that no nonbank bank at this time was in difficulty. And I don't necessarily see banks wanting to go into other fields, because they cannot operate banks. I don't think that is the problem at all.

I think that what we have seen and what we are seeing in this country, is the definition of a new financial marketplace. And if we are going to have a new financial marketplace, then we should let the regulated financial institutions address that financial marketplace again with the insurance of safety and soundness, but we certainly shouldn't separate and segregate the banking industry from the free market system.

And I would say that this is a timely subject that we in the House and this committee need to address. I don't see banks trying to run into areas they cannot anticipate when we see others in the same businesses, in the banking business, operating very successfully.

And I will yield.

Mr. McKINNEY. Would the gentleman give me 15 seconds simply to say other industries in this marketplace are not insured by the full faith and credit of the taxpayers of the United States——

Mr. BARNARD. And neither are the holding companies operating individual subsidiaries, individually capitalized and operating not in the scope of the banking system.

Mr. McKINNEY. I would suggest to my good friend, he look at what we did to Continental Corp., where we saved the holding company and not the bank because of bearer bonds.

Mr. BARNARD. No, it was not. We did that——

Chairman ST GERMAIN. The chairman—I realize you have been sitting here, too, but we have a lot of witnesses to hear from. Governor Partee has some important work to do. I tell you what, I am going to ask both of you to stay at the conclusion of the panel. I will sit here and listen, and let you two go back and forth.

Mr. BARNARD. My time has not expired.

Chairman ST GERMAIN. That is what you think.

Mr. BARNARD. I haven't been notified my time has expired. I was awarded my time by Mr. Gordon, and I demand to have the time.

Chairman ST GERMAIN. You have it.

Mr. BARNARD. The distinguished gentleman and learned gentleman from Connecticut is absolutely wrong about Continental. It was not the bearer bonds. We know going to the holding company was the only way it could be done, and second, we had 2,000 banks that were in jeopardy if Continental had failed.

I give back the rest of my time to Mr. Gordon.

Chairman ST GERMAIN. Governor Partee, aren't you glad you came?

Mr. PARTEE. I think it is quite entertaining, yes, Mr. Chairman.

Chairman ST GERMAIN. You like it this way, don't you? At this point, I would ask unanimous consent to place in the record a letter from FDIC—at the conclusion of Governor Partee's testimony and questioning, and prior to the panel—dated September 10, 1985, a letter from the OCC dated September 29, a statement from

Mr. Walter Madsen, Conference of Bank Supervisors, a statement of the New York State Bankers' Association and also a statement from the Alliance of American Insurers. Is there any objection?

The Chair hears none.

[The material for the record follows:]

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington D C 20429

OFFICE OF THE CHAIRMAN

September 10, 1985

Honorable Fernand J. St Germain
Chairman, Subcommittee on Financial Institutions
  Supervision, Regulation and Insurance
House Committee on Banking, Finance
  and Urban Affairs
B-303 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

You have invited the FDIC to submit a statement regarding the "South Dakota" issue -- the authority of a state to preclude a bank chartered by it from conducting nonbanking activities within that state while permitting the same banks to conduct these activities in other states.

For the most part we have favored state actions to expand the activities in which banking organizations can engage, although we have favored the placement of certain nonbanking activities (*e.g.*, securities and insurance underwriting and real estate development) in bank subsidiaries or holding company affiliates. Most state expansionary actions have been taken after weighing earnings opportunities for banks, bank safety-and-soundness considerations, the provision of services within the state, potential conflicts of interest, and political and economic considerations related to local nonbank competitors.

South Dakota, in granting insurance authority to state chartered banks, has apparently been motivated by a desire to bring out-of-state resources into South Dakota, creating jobs and revenues. Because the banks involved are subsidiaries of out-of-state institutions and may not engage in the activities within the state, South Dakota has not had to deal seriously with safety and soundness or even political considerations. Regulatory matters related to insurance activities will have to be dealt with by other states. To the extent that bank participation in insurance increases competition and provides public benefits, these benefits will not even be available to South Dakota residents.

We believe that South Dakota has not acted properly in seizing an opportunity to realize financial gain at the expense of other states without having to take responsibility for its actions. A state should not be permitted to authorize bank activities outside its borders that are not permitted within the state. At the same time, we are strongly opposed to federal legislation to curtail the rights of the states to determine the permissible scope of activities of state-chartered banks where the states do not attempt to ban the activities within their own borders. Such broad legislation is not necessary and would undermine the dual banking system which has served this nation well for over a century.

Sincerely,

William M. Isaac
Chairman

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 9, 1985

Dear Chairman St Germain:

You have asked us to submit our comments on the so-called "South Dakota" issue. We are happy to provide you with this statement and ask that it be included in the record of the hearings which you have scheduled on this subject.

In the past, we have supported legislation, such as provisions in S. 2851 and H.R. 5734 in the 98th Congress, which would prohibit states from permitting state banks to engage in out-of-state activities on a different basis from that permitted inside the state. We believe this so-called "South Dakota loophole" is inequitable, and support legislation to close it.

Although we support legislation to close the South Dakota loophole, we are concerned with the manner in which some of the pending legislation proposes to do so. Some bills, such as H.R. 15 and H.R. 1513, amend Section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. § 1843(c)(8)) to extend the prohibition against certain insurance activities by non-banking subsidiaries to all subsidiaries and affiliates, including banks, of bank holding companies. We strongly object to these provisions which, in our view, go further than is necessary to close the South Dakota loophole.

We believe H. R. 15 and H. R. 1513 would significantly alter the existing statutory scheme which provides that the Bank Holding Company Act governs the activities of bank holding companies and their nonbanking subsidiaries, while the National Bank Act and state laws apply to national and state banks, respectively. We feel these provisions would extend the jurisdiction of the Federal Reserve Board to include state bank and national bank subsidiaries of bank holding companies, thus undercutting a major role of state banking authorities and of the Comptroller and compounding the existing overlap in the jurisdictions of the bank regulatory agencies. We would hope that if such fundamental changes were to be made, they be made in the context of comprehensive Congressional action, not as a loophole closing measure.

In sum, while we support Congressional action to close the South Dakota loophole, such legislation should not expand the scope and restrictions of the Bank Holding Company Act, currently applicable to bank holding companies and their nonbanking subsidiaries, to include their bank affiliates and subsidiaries.

The Office of Management and Budget has advised that there is no objection from the standpoint of the Administration's program to the submission of these views.

Thank you for this opportunity to provide our views. We will be happy to provide further information if you have any questions concerning our submission.

Sincerely,

H. Joe Selby
Acting Comptroller of the Currency

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance
and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

STATEMENT OF MR. WALTER C. MADSEN
ON BEHALF OF
THE CONFERENCE OF STATE BANK SUPERVISORS
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
U. S. HOUSE OF REPRESENTATIVES

RE: STATE AUTHORITY OVER THE ACTIVITIES OF
STATE-CHARTERED INSTITUTIONS

SEPTEMBER 11, 1985

Mr. Chairman, members of the Committee, I am Walter Madsen, Superintendent of Banks for the State of Arizona and President of the Conference of State Bank Supervisors, on whose behalf I am filing this written statement for the record.

The Conference of State Bank Supervisors (CSBS) is the professional organization of state officials who charter, regulate and supervise the approximately 10,500 state-chartered commercial and savings banks of the nation. Created in the early 20th Century as a clearing house for the ideas of the state bank supervisors on common problems, CSBS has evolved into the major champion of our decentralized American banking and bank regulatory structures. In addition, the Conference has become the most significant single source of educational and research services aimed at strengthening individual state banking departments.

We are pleased to have this opportunity to file a written statement for the record regarding state authority over the activities of state chartered institutions. CSBS, of course, opposes broad preemption of state authority over the activities of state-chartered nonmember banks.

State Authority Under the Bank Holding Company Act

In the early 1950's, supporters of the decentralized dual banking system became concerned with the growth of multi-bank holding companies, which were evading state branching laws by creating numerous subsidiary banks, both within and across state lines, and operating such banks essentially as branches. In addition, there was deep concern over moving too quickly and too far in the areas of permissible bank holding company activities and corporate ownership of financial institutions.

The Bank Holding Company Act of 1956 ("BHC Act") was enacted to accomplish two primary objectives: "it was designed to prevent the concentration of banking resources in the hands of a few financial giants", and "it was intended to implement a Congressional policy against control of banking and nonbanking enterprises by a single business entity." As the U.S. Supreme Court recently noted, "underlying both objectives was a desire to prevent anticompetitive tendencies in national credit markets." The Bank Holding Company Act reflected the fundamental emphasis in federal banking policy on maintenance of local control over banking and avoidance of large conglomerates that could result in excessive concentrations of economic and political power.

The BHC Act struck a balance between state and federal authority pertaining to both the non-bank subsidiaries (Section 4) and the bank subsidiaries (Section 3) of a bank holding company. Bank subsidiaries are chartered and operated as institutions whose powers are determined by state banking codes and the National Bank Act for state-chartered and national banks. Limited in function, banks are generally limited in geographic scope of operations as well. That is, the application of the McFadden Act to both bank branches and other bank operations which perform bank branch functions has limited such activities to a bank's home state. On the other hand, non-bank subsidiaries of BHCs are by their corporate nature more readily available for interstate activity. Once incorporated, their activities generally follow the industry pattern of their non-BHC-owned competitors. Personal loan companies and mortgage finance companies, for example, may follow local laws and regulations within the states in which they operate, but they typically operate in more than one state.

A clear scheme of authorization and regulation is evident, distinguishing between deposit-taking banks and other corporations, the stock of which is held by the holding company. This Congressionally designed system is both logical and consistent with the concept of a dual banking system. States are basically free to permit state-chartered financial institutions to serve the public in ways consistent with the needs of each individual state, limited naturally by the controls on location with which banks must comply, which are also administered by the state. Interstate general corporate activities of holding companies, on the other hand, are controlled by the Congress, the Federal Reserve Board and the states, both as to type of activity and location. It was never intended that the activities of the bank subsidiaries of a BHC be limited to those activities approved for corporate subsidiaries other than banks.

The Garn-St Germain Act and the Citicorp Application

Congress, in Title VI of the Garn-St Germain Depository Institutions Act of 1982, determined that bank holding companies should be limited in establishing non-banking corporate subsidiaries to engage in the underwriting and sale of insurance products. Several of the exceptions to this general rule are of a geographically limiting nature. They include: credit-related insurance provided where the bank holding company has an office and has made a personal loan, and insurance activity in towns so small as to induce only an already-present bank holding company to sell insurance there. In the grandfathering provisions, insurance activities are allowed in the state in which the bank holding company has its principal place of business, in neighboring states or in states in which a bank has already sold insurance prior to the grandfathering date. Finally, small bank holding companies, under $50 million in total assets, are exempted since they are likely to be locally-oriented and not engaged in extensive out-of-state adventures.

Limitations on interstate corporate operations of BHC non-bank subsidiaries did not preempt state authority over state-chartered nonmember banks, both because of the limited nature of such activities and because to do so would have been out of step with the historical development of the dual banking system. In many states banks have long engaged in such activities under state law as a bank function; i.e., as part of the intrastate activities normally carried out in a bank or in its branches. Thus, the Garn-St Germain Act preserved the status quo as to state authority over its state-chartered institutions.

That balance, however, was threatened by an application of Citicorp to establish a subsidiary of a state-chartered bank in

South Dakota which would sell insurance nationwide, the provisions of the Garn-St Germain Act notwithstanding. This application was made pursuant to authority found in both the Federal Reserve Board's Regulation Y and the state statutes of South Dakota.

In 1971, the Federal Reserve Board amended its Regulation Y, which pertains to the activities of bank holding companies, to provide that a subsidiary of a bank might do anything which the parent bank might do. The purpose of this was to allow segregation of certain bank-related activities for management purposes.

In 1983, South Dakota enacted a law which permitted state banks to engage in insurance underwriting and brokerage activities. Such activities could be carried on on an interstate basis by a subsidiary of the bank pursuant to Regulation Y.

The question raised by the Citicorp application was whether an out-of-state bank holding company could use the South Dakota insurance statute to offer interstate insurance activities, which it would otherwise be precluded from offering by the BHC Act.

On August 1, the Federal Reserve Board (the "Board") denied Citicorp's application to acquire a South Dakota bank (American State Bank of Rapid City) for the purpose of engaging in underwriting insurance and acting as agent or broker for the sale of all lines of insurance on a nationwide basis. The Board denied the proposal on the ground that it represented a clear evasion of the purposes of the BHC Act. The Board concluded that the acquisition of the South Dakota bank was simply a device to permit Citicorp to engage in insurance activities prohibited for bank holding companies. The Board noted that "the bank will serve primarily as an insurance subsidiary of Citicorp and will conduct relatively insignificant banking activities." The Board decision effectively proscribes BHC entry into insurance activities without doing unwarranted damage to the role of the agencies - both state and federal - which charter banks.

This decision underscores the fact that there never has been a so-called "South Dakota loophole" in the Bank Holding Company Act. While states have the authority to determine the powers of the institutions which they charter, the Federal Reserve Board has the authority to turn down applications by BHCs which are inconsistent with the purposes of the BHC Act. Use of a state's banking law to set up an insurance subsidiary, although a bank in name, for the export of insurance services interstate, as proposed by Citicorp is not legal under the existing statutory scheme.

The Need for Congressional Action

No Congressional action is required at this time.

CSBS would oppose any attempt to limit the activities of state-chartered institutions, carried on within the borders of their home state, to those activities on the "laundry list" of approved corporate activities. Such an amendment would constitute an unwarranted overreaction to a single bank holding company's unsuccessful attempt to use state law for the interstate export of a state bank's insurance activities. It would be an unprecedented and unjustified preemption of the authority of states to regulate within their own borders.

The proposition that state-chartered banks affiliated with a holding company should be limited to the insurance activities permitted to corporate, non-banking subsidiaries of the holding company ignores the legislative history of the Bank Holding Company Act and precedents within the dual banking system.

The Senate Report accompanying the Bank Holding Company Act of 1956 (Senate Report No. 1095, July 25, 1955), made it clear that the dual banking system was to be preserved and extended into bank holding company regulation. It noted, "Considerable care has been taken to provide regulatory control over individual banks by Federal and State authorities. Yet there is at present only a very limited control over the activities of bank holding companies that manage or control banks." The history then outlines a scheme of parallel authority over bank acquisition and operation in which the individual authority, the OCC or the State, retained its dominion over national or state-chartered banks, respectively. Yet, the bill treated regulation of the corporate side of bank holding companies differently, giving initial jurisdiction over the permissible corporate activities to the Federal Reserve Board, with a general reservation of power to the state, viewed primarily as "a right to be more restrictive regarding the formation or operation of bank holding companies within their respective borders than the Federal authorities can be or are under this bill." Referring to the reservation of powers clause (Section 7), the report states, "In the opinion of the committee, this provision adequately safequards States' rights as to bank holding companies."

It is clear from the legislative history of the 1956 Act that individual authority of the OCC and the States were to be preserved as to their depository institutions, while the general thrust of the Act was to restrict interstate corporate activities of bank holding companies. This approach was continued in the 1970 amendment to the Act, in which a "more difficult standard" was adopted for non-banking activities to be approved by the Fed, but OCC and state authority over individual banks was left undisturbed.

In the 1970 debate over acceptable "closely related" (Section 4(c)(8)) bank holding company subsidiaries, Congress was the agency which would give specific authorization for new, non-bank corporate activities of bank holding companies. The Congress was able, through this decision, to fill the perceived gap between bank regulation adequately carried out by the OCC and state regulators and other activities carried out by corporate subsidiaries of companies which owned banks. Congress did not establish centralized Federal Reserve controls over national and state-chartered bank activities. Such a move, it was recognized, would have marked a radical departure from the dual banking system as opposed to the role of the Bank Holding Company Act as the controller of intercorporate affairs between banks and holding company-owned non-banking subsidiaries.

Congress has in recent legislation consistently chosen to keep the Federal Reserve out of the regulation of state-chartered nonmember banks. In the 1980 Monetary Control Act, Congress rejected mandatory Fed membership (and subsequent regulatory jurisdiction by the Fed) as a measure to help solve the Federal Reserve's declining membership problem. In the International Banking Act, Congress determined that provisions of the Federal Reserve Act which are concerned with the Fed's supervisory authority should not be extended to nonmember depository institutions. In the Export Trading Company Act, the Congress eliminated proposed extension of Federal Reserve supervisory authority into areas already adequately covered by state law.

A consistent pattern of parallel regulation has been achieved. The Federal Reserve serves an important role in the Bank Holding Company Act as arbiter of those Section 4(c)(8) corporate activities closely related to banking. However, expansion of Federal Reserve Board regulatory authority over state nonmember banks has been consistently rejected. Such extension would be inconsistent with the well-established view of Congress that the dual banking system already adequately assures effective supervision of state-chartered banks.

The proposition that state-chartered banks affiliated with a holding company should be limited to the insurance activities permitted to corporate, non-banking subsidiaries of the holding company ignores some basic facts about bank holding companies.

As of December 31, 1982 there were 4,510 bank holding companies, the vast majority of which owned one bank and were organized in the holding company format for securities and tax law purposes. In other words, most one-bank holding company banking operations are not different than those of similar sized banks not in a holding company format. Thus, a limitation to the non-bank activities list would both unjustifiably affect thousands of institutions and create differences in powers for similar banks chartered under the same law.

The proposition that state-chartered banks affiliated with a holding company should be limited to the insurance activities permitted to corporate, non-banking subsidiaries of the holding company ignores the very real public benefits provided by our dual banking system, which would be undermined.

States operate as laboratories for change. Many states have long permitted activities which are not in all respects identical to those of either national banks or non-bank subsidiaries permitted under the Bank Holding Company Act. The ability of states to charter banking corporations carries with it the duty to determine an appropriate scope of activities. Such responsibility has resulted in important public benefits, has led to banks meeting local or specialized needs and has often resulted in subsequent action by Congress authorizing similar functions; e.g., bank branching in the 1920's and 1930's and NOW accounts in the 1970's. Indeed, one of the benefits of the dual banking system is that is motivates experimentation and innovation without putting the entire banking system at risk.

State powers lead to local service and flexibility. Because current Congressional activity was occasioned by a state's insurance statute, it is appropriate to begin with an examination of insurance activities of state-chartered banks under state law. Local conditions have led many states to authorize state-chartered banks to meet local insurance needs. State law, regulations and interpretations promulgated thereunder, court decisions and longstanding tradition permit insurance brokerage -- for at least credit-related insurance -- in 29 states. Ten of these states allow some amount of general insurance brokerage as well. Six states, including South Dakota, allow some amount of insurance underwriting. It is clear that the longstanding exercise of this authority neither has occasioned the dire results opponents have asserted, nor has produced anything other than service within the granting states. Legislation prohibiting such activities within the authorizing states would be anti-competitive and an inappropriate remedy for the ills alleged.

State authority over the powers of state-chartered institutions has added a healthy degree of flexibility to our banking system. It is difficult to believe that the significant loss of flexibility and service to local communities could be justified in prohibiting activities which engender no safety and soundess risk.

Congressional preemption of state authority in this area is not in the public interest; would cast too large a net, given the

Fed decision in the Citicorp case; would remove from the public services which have been offered without controversy until now; and would create unequal and unfair regulation based on organizational structure. Congress is being asked to act unnecessarily. Congress is being asked to pass legislation which would constitute an unwarranted preemption of state authority, which is anti-competitive, anti-consumer and anti-state government. CSBS strongly opposes this incursion into state authority under the dual banking system at the behest of an industry which has for years benefited from the reservation of authority to states under the McCarran-Ferguson Act.

Conclusion

CSBS strongly believes that state authority over state-chartered banks within each state's borders should be retained. The Federal Reserve Board has demonstrated its authority under the current statutory scheme to deal with attempts to use such state laws to circumvent the purposes of the Bank Holding Company Act. No Congressional action is necessary.

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STATEMENT OF THE NEW YORK STATE BANKERS ASSOCIATION

TO THE

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
ON THE "SOUTH DAKOTA" ISSUE

September 11, 1985

The New York State Bankers Association, representing New York's commercial banks, appreciates the opportunity to provide this statement opposing any federal preemption of the ability of states to authorize additional powers for their state-chartered banking institutions. We are particularly concerned with attempts in Congress to foreclose state-chartered institutions from offering insurance products. We strongly believe that consumers would greatly benefit from banks selling insurance, and are supported in this belief by New York Governor Cuomo[1] and the National Insurance Consumer Organization.[2] This statement will briefly discuss the status of this issue in New York and outline the significant consumer benefits if banks are permitted to sell insurance.

In February 1984, the Temporary State Commission on Banking, Insurance and Financial Services (the "DeWind Commission") issued a report containing its recommendations for the future of the financial services industry in New York. The legislatively created Commission was composed of representatives from the banking, insurance and securities sectors, as well as those who spoke for the public at large. The Commission spent more than half a year intensively exploring how the financial services industry could best adjust to the realities of a less regulated environment and how it could best serve the public.

The Commission's Report sets forth 38 specific recommendations addressing a wide range of issues, one of which is that banks be permitted to act as insurance agents and brokers.[3] The Report, which is strongly pro-consumer, also recommends that banks selling insurance be required to provide lifeline services. It proposes a number of consumer protection measures to guard against possible insurance/credit tie-ins, including a thirty day cooling-off period during which a consumer may cancel any insurance policy purchased at a bank without penalty. Legislation encompassing these proposals has been introduced in the State Legislature at the request of Governor Cuomo, and this Association is aggressively working for its enactment. We are therefore very concerned about the possibility of any federal preemption in this area.

The DeWind Commission made the following finding regarding banks and insurance:

> The Commission believes that all banks, regardless of size, charter type or holding company affiliation, should be able to act as agents or brokers for the sale of insurance. As in other industries where entry barriers have been removed, entry of banks into this segment of the insurance industry should increase competition; result in greater convenience to consumers; lead to innovation in sales and distribution methods; and, ultimately, result in improved and more specialized services and lower premiums (and thus lower costs to consumers) as banks and other providers target price-sensitive customers.[5]

Specifically, consumers will benefit from banks selling insurance in five important ways: lower costs; greater convenience; better information; fairer treatment; and more choices.

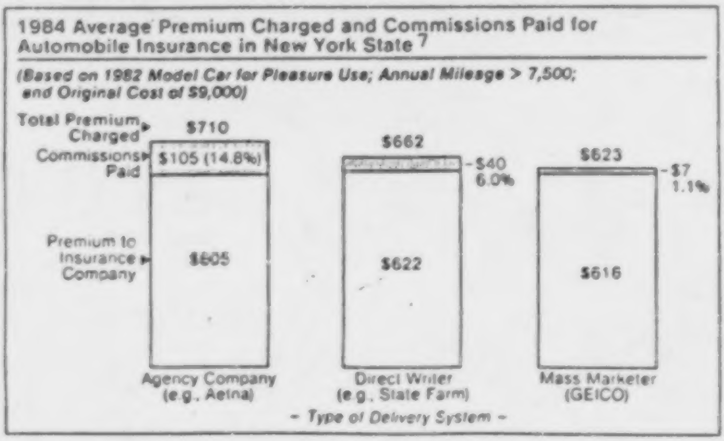
Lower Costs

For years, the distribution of automobile, homeowners and life insurance has mainly depended on traditional delivery systems that use brokers and agents. This has added significantly to the overall cost of insurance with the average New York household paying $200 in commissions each year to obtain coverage. In 1983, New York consumers paid approximately $1.3 billion dollars or about 15 cents out of every insurance dollar spent for agent or broker commissions.

New York State - Retail Insurance Market 1983 Estimate[6]
($ Millions)

	Premium Paid	Commissions Paid $	Commissions Paid % Premium
Automobile	$3,081	385	12.5
Homeowners	1,002	170	17.0
Ordinary Life	2,797	559	20.0
Accident/Health	443	53	12.0
Annuities	1,162	101	8.7
Total	8,485	1,268	14.9
Average per Household	1,338	200	14.9

Today, by reducing the role of intermediaries, there are more cost effective and efficient ways to distribute insurance. Those insurers who have chosen these ways are able to offer lower premiums (see chart below) and have gained popularity with consumers. Banks, as new entrants in this business with relatively low incremental costs, would similarly offer the consumer cost savings through a more efficient delivery system. Consumers should have the maximum opportunity to choose between traditional insurance delivery systems and less costly alternatives.

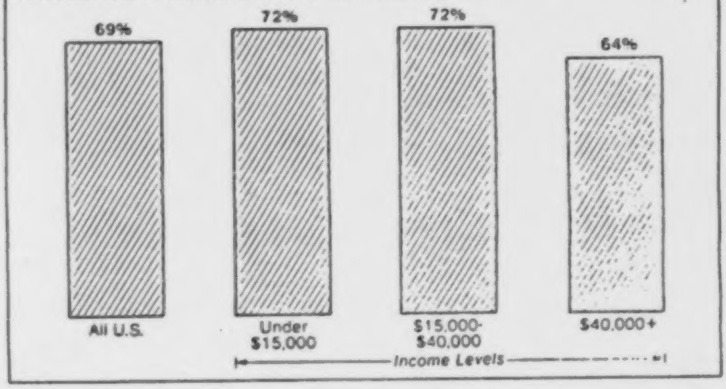

1984 Average Premium Charged and Commissions Paid for Automobile Insurance in New York State[7]

(Based on 1982 Model Car for Pleasure Use; Annual Mileage > 7,500; and Original Cost of $9,000)

Greater Convenience

Bank entry into insurance will also afford consumers the convenience of one-stop shopping. Credit and debit cards, drive-in banking, electronic banking, home bank terminals, and discount brokerage are all examples of how banks have responded to customer demands in the last decade. As is shown in the chart below, consumers of all income groups overwhelmingly agree it would be convenient to purchase all financial services from one firm. (Sears is an example of one such firm acting on this strong consumer preference.) Through bank branch networks and offices in both large and small communities, banks have the ability to make insurance available in towns and cities of every size at lower costs.

Percentage of U.S. Households Agreeing It Would Be Convenient to Purchase All Financial Services from One Firm[8]



Better Information

In addition to lower costs and convenience, banks will provide fuller and clearer disclosure of prices, coverage and other terms and conditions of the insurance products they offer. Consumers are often confused by the complexity and terminology of existing insurance contracts and sales practices. The Commission's recommendations specifically require banks to provide clearer and more complete disclosure than is currently required from agents and brokers.[9] Such disclosure will enable consumers to shop for the best insurance rates, coverage and services.

Fairer Treatment

Other specific statutory prohibitions contained in the DeWind Commission proposals and legislation will result in fairer treatment for insurance consumers. As mentioned above, we endorse the strengthened prohibitions against coercion and tie-in sales, including the 30-day cooling-off period. These provisions will also assist consumers in seeking out the best insurance value wherever it is found.

More Choices

Finally, allowing banks to offer insurance will substantially increase the number of insurance providers and products available to consumers. Banks are well aware that consumers want the best yield on their savings and the most favorable loan rates. Similarly, consumers are demanding different and more economical insurance products to meet their changing needs. Bank competition to meet these insurance needs will bring more innovative products to the marketplace.

New York's experience with Savings Bank Life Insurance and credit life insurance lend support to the notion that consumers will reap significant benefits if banks are allowed to expand their insurance activities. Since 1938, New York savings banks have been authorized to make low cost life insurance coverage available to individuals who live or work in New York. A 1982 study by the New York Department of Insurance showed that premiums for a $25,000 SBLI policy were at least 13% lower than the average premium for other whole life policies.[10] In addition, vigorous legislative and regulatory control over credit life insurance rates have resulted in New York having a 53% lower maximum allowable rate than the national average. This rate is at least 90 cents lower per thousand dollars of debt per year than the next lowest state's legislative maximum (eg., New York - $2.80 per thousand; New Hampshire - $3.70 per thousand).

We strongly urge that Congress not preclude New York from authorizing its banks to sell insurance. Regulation of insurance activity has long been in the exclusive province of the states. To impose any federal interference in this instance would severely disadvantage consumers and undermine the ability of the states to determine their insurance needs.

Respectfully submitted,

James P. Murphy

James P. Murphy
Executive Vice President

attachments

FOOTNOTES

1. Press Release from Governor Cuomo's office, April 18, 1984.

2. Testimony of J. Robert Hunter, President of the National Insurance Consumer Organization Before the Committee on Banking, Housing and Urban Affairs of the U.S. Senate on S.2181, March 13, 1984. See also, J. Robert Hunter, "Banks in Insurance: A Consumer Viewpoint", Banks in Insurance Report, April 1985 (attached).

3. The recommendations of the DeWind Commission regarding banks acting as insurance agents and brokers are attached.

4. New York State Senate Bill 3268 and New York State Assembly Bill 3452 (1985).

5. Page 128 of the Report of the Temporary State Commission on Banking, Insurance and Financial Services ("DeWind Commission Report").

6. Premiums
   Best Executive Data Service, 1984 Editions, Property & Casualty Insurance, Life-Health Industry Marketing Results
   Commissions Paid
   Property & Casualty - Best's Aggregates & Averages, 1984, Life - Industry Estimates
   Households
   1980 U.S. Census - New York State, Total Number of Households, 6,340,400

7. Premium data extracted from Insurance Service Office Inc. (ISO) New York private passenger automobile premium comparison revised, October 9, 1984. Data represents a weighted average of companies included in report, premium volume with sample rates from 8 rating territories (05, 07, 11, 12, 13, 18, 68 and 73).
   Commission paid data - source Best's Aggregates and Averages 1984. Weighted average of companies reporting ISO report.

8. Stanford Research Institute International - 1982 Consumer Financial Decisions, March, 1983.

9. Pages 159-161, DeWind Commission Report.

10. Consumers Shopping Guide for Life Insurance, cost comparison tables, New York State Department of Insurance, 1982.

Banks in insurance: a consumer viewpoint

J. Robert Hunter
President
National Insurance
Consumer Organization

Consumer benefits from bank insurance will depend on more courageous regulation.

In the debate over banking deregulation and the trend toward the financial services "supermarket," a potential for consumer benefits is invoked by most of those who desire an open and level playing field. Not until recently, however, have consumers and their spokespersons been consulted on what they think is best.

In seeking to protect consumers in the area of insurance sales in and by banks, there are several major questions that must be asked: 1) Should banks be allowed to underwrite and/or sell insurance? 2) If so, what agency or agencies should regulate this activity? 3) How will consumers get quality information about service levels and prices, given the complex array of new products which may be developed by new competitors? 4) What new problems, such as tie-ins, might arise for consumers? 5) Would the entry of banks into insurance lead to a significant concentration of financial resources?

A role for banks

The entry of banks into direct writing of insurance would definitely increase competition in the insurance business and would be a boon to consumers. Today, competition in the personal lines, such as life, auto and homeowners', is seriously impaired because of the difficulty of entering the direct writing business compared to entry into agency writing. Entry barriers are inherent in both the economics of direct writing and in the legal impediments of old common-law rules.

Direct writing requires an extensive distribution system using either employees or exclusive agents. It also requires considerable name recognition by the public. These and other marketing essentials require a substantial initial investment for most organizations, but banks have both the distribution system and the reputation required to enter the business with comparatively little outlay of cash.

On the legal side, entry into direct writing is inhibited by the common-law rule that "property rights" in the insurance customer belong to the agent, not to the underwriting company. This means that when an underwriter or even an agency company desires to move into the direct writing business, they have to start from scratch; they cannot start with a foundation of existing insureds. When the Insurance Company of North America attempted to enter the direct writing field a few years ago, its agents threatened retaliation and INA was forced to back down.

The ease of entry into agency writing, on the other hand, benefits consumers only if new entrants make their presence felt at the consumer level by competitive pricing and other added values. To the extent that agency writing uses or tracks bureau rates, competition in this segment of the industry is restricted. Competition is also reduced by resale price maintenance, where the wholesaler—the insurer—sets the retailer's—the agent's—remuneration, reminiscent of Fair Trade Law days.

Regulation

The problems of Baldwin-United make it crystal clear that the current ap-

NATIONAL INSURANCE
CONSUMER ORGANIZATION

proach to insurance consumer protection is woefully inadequate. Some twenty states have no insolvency fund to cover events like the Baldwin disaster. No state is prefunded. One state insurance office has indicated that it would take eighty years to pay off Baldwin claimants if the insolvency fund is triggered. The state-by-state crazy quilt of insurance regulation and consumer protection needs a thorough reexamination. It is possible that a federal insolvency mechanism for insurance protection, along the lines of FDIC deposit insurance, may be needed regardless of whether banks enter the insurance field or not.

The emerging financial services industry offers a unique opportunity for state and federal regulators to come to grips with the question of which regulator is best equipped or best placed to deal with the various requirements of regulation. It may be that the states should be responsible for managing consumer rights and consumer complaints, while the federal government should take responsibility for data collection and analysis and for general supervision and adequate solvency protection for all insurance customers. In any case, this is not the time for bureaucrats to fight over their turfs; what is needed is careful research and judgments regarding the common good and the health and soundness of the financial services system.

Information

Given the massive and rapid changes in financial services, how is the individual consumer to decide what is best for his or her unique situation? Where is the consumer to gain the information necessary to make the rational decisions that are the keystone of productive free enterprise?

Fortunately, the same technology that makes possible the proliferation of products and services also makes possible the collection and distribution of information. Home computers, cable television, and entrepreneurial ventures at the frontiers of information exchange have only begun to suggest the potential for the development of comprehensive information brokerage. I envision the day when, for a few dollars, a consumer can instantaneously get a list of the ten least expensive home insurance policies with an analysis of how their benefits and drawbacks differ in relation to the consumer's individual situation. Similar information would be available regarding securities brokerage, savings instruments, checking accounts, etc.

Government should make it possible for such information brokers to exist by ensuring their access to the records and other information presently collected by government agencies. The information broker would then computerize this information and prepare it for easy access by the consumer public. This process would not impose additional recordkeeping tasks on either the financial services industry or, except in a few states, on regulators. Finally, it must be noted that the availability of such information would greatly ease the problem of tie-ins.

Technology has only begun to suggest the potential for the development of comprehensive information brokerage.

Consumer protection

The insurance consumer's sharpest concern is the potential for tie-ins and coercion in the financial services supermarket. Do not underestimate consumer anxiety that banks will, directly or indirectly, require the purchase of their insurance as a condition for loans. Nor is this an issue only for banks. It is quite common for an insurer to be willing to underwrite an auto risk if the consumer is prepared to buy a homeowner's policy as well.

Regulators must consider more carefully how best to restrain and end these abusive practices. That courageous regulation can mitigate abuses in this area is illustrated in New York. While credit life insurance tie-ins are an abomination in most states, control of credit life rates in New York has successfully blunted the negative effects of tie-in practices there. However, most states have not been able to overcome the tremendous lobbying pressure of banks and other lenders, car dealers, and insurance companies against effective consumer protection.

On the other hand, savings bank life insurance, offered in several states, has generally been inexpensive, pro-consumer and apparently free of tie-in practices. It is also clear that several lines of insurance do not lend themselves to tie-ins, e.g., health insurance. Furthermore, even tie-ins on home and auto loans might only be for the first policy term. Thereafter, other insurance sellers would be free to compete for those premium dollars. After all, people are used to buying homeowners' and auto insurance in places other than banks.

Nevertheless, further safeguards against tie-ins should be enacted. Loan applications and agreements should state clearly in bold and colored print that the borrower is free to buy insurance elsewhere. When a policy is delivered, it should be accompanied by a similar notice which the borrower would sign and return to certify that he or she understands the notice. The cooling-off period should begin with the borrower's receipt of the policy and extend for only fifteen days. (Experience suggests that consumers act at once in face of a short period, but delay and forget if given a longer period.) Insurers and lenders should be required to facilitate the transfer of information to the information brokers discussed above. Finally, these protections should be extended to all current credit-related insurance sales.

Concentration

Will there be an undue concentration of economic power in financial conglomerates? While I do not want to minimize that danger, I do think a significant concentration in the insurance industry is inevitable, even if there is no merging of the various financial service roles.

Do not underestimate consumer anxiety that banks will require the purchase of their insurance as a condition for loans.

Thousands of employees have already been laid off by merging insurance companies. Hundreds, perhaps thousands of insurance companies are so inefficient that they would not survive if it were not for the lack of meaningful competition under the broad antitrust exemptions of the McCarran-Ferguson Act (a federal law passed in 1945 which also delegates insurance regulation to the states). I believe it is quite likely that the number of insurers will decline by 80 to 90 percent over the next fifteen years as the less efficient ones fall by the wayside.

Over the last thirty years, major lines of insurance in the property/casualty field have become more and more concentrated. Today, many state markets are concentrated at oligopoly levels and studies indicate that this trend is accelerating, particularly in auto and homeowner insurance. More research is needed, but it does seem likely that, in the long run, the entry of banks into the direct writing business would reduce concentration in the insurance industry and save jobs.

It is the view of the National Insurance Consumer Organization that the barriers between financial institutions should come down. There is no justification for prohibiting competition among concerns that meet the economic criteria for such activity. That is not to say that there should not be ways to control potential abusive practices, but once the supervisory structures are worked out and in place, no impediments to competition should be permitted. Banks should be allowed to enter the insurance business.

To Our Subscribers

Due to delays in inaugurating the *Banks in Insurance Report*, the first issue of the *Report* was published in March. Charter subscriptions will therefore be valid through the February 1986 issue.

From the Report of the Temporary State Commission on Banking, Insurance and Financial Services (February 15, 1984)

IV. SPECIFIC POLICY RECOMMENDATIONS

1. Bank/Insurance Activity Affiliations

The laws which limited the activities of depository institutions at both the state and federal levels to those considered incidental to traditional banking business or (under the Bank Holding Company Act) to activities deemed both a "proper incident" to banking and "closely related" thereto, apply to all aspects of bank involvement in the insurance business. Likewise, legal limitations on the investments and permitted ownership of subsidiaries by New York insurance companies had the effect, until 1983, of excluding such companies from banking as well as most other business. These rules, however, are the result of more than 75 years of growth and evolution, much of it in response to experiences of times much different than our own. As a result, many other financial firms are not subject to such activity limitations; in recent years many such firms have become close competitors of banks in both their deposit-taking and lending functions, yet are able to engage in a wide range of insurance activities prohibited to their banking competitors. Thus, as noted previously, banks have been disadvantaged in competing for both their traditional customers and those who logically might look to banks for other services. New York insurers similarly have had less freedom than their out-of-state competitors to acquire deposit-taking institutions, including both thrifts as well as banks and "nonbank banks".

The Commission has concluded that, to a substantial extent, the remaining legal and regulatory barriers to entry between banking and insurance firms are no longer required to serve important public policy objectives, and appropriately can be removed in a short period of time. The Commission believes that gradual removal of these barriers will lead to increased competition and corresponding benefits to consumers, increased commercial opportunities for New York firms in both existing industries, and increased growth and welfare for the State as a whole.

The Commission thus recommends that State-chartered banks and thrifts be authorized to act as agents and brokers for the sale of insurance, either directly or through subsidiaries; that the existing statutory bar against banks selling property insurance to borrowers be repealed and replaced with a variety of specific measures to protect consumers; that State law authorize future corporate affiliations between banks and insurance companies through a holding company structure; and that banks and domestic mutual insurers eventually be authorized to enter each other's business through direct subsidiaries, with a limited capital investment, if Congress does not permit such affiliations through holding companies by specific dates.

These proposals are outlined and discussed in detail in the sections that follow.

Proposal No. 1

Beginning January 1, 1985, banks (commercial banks, savings banks and savings and loan associations) should be authorized by statute to act directly as insurance agents and brokers. Banks should be authorized to sell insurance both on the premises of their existing branches or at other locations. In addition, their authority to lease space in branch locations to independent insurance agents in accordance with current Banking Department interpretations should be confirmed by statute.

Discussion

Under current law, the authority of depository institutions to engage in insurance agency activities varies among institutions. Except in communities under 5,000 population, both national and state-chartered commercial banks are prohibited from engaging in agency activities directly, although it appears that the Banking Board, if it chose to do so, could authorize a State-chartered commercial bank to own an agency or brokerage corporation. In accordance with regulatory interpretations, both national and State-chartered banks can lease space in their branches to unaffiliated agents for a rental based in part on a percentage of the agent's commissions. Banks with less than $50 million in assets that are members of a holding company can offer property and casualty insurance through corporate affiliates. Through service corporations, thrifts can become involved in the full range of agency activities, and many in fact have done so.

The Commission believes that all banks,* regardless of size, charter type or holding company affiliation, should be able to act as agents or brokers for the sale of insurance. As in other industries where entry barriers have been removed, entry of banks into this segment of the insurance industry should increase competition; result in greater convenience to consumers; lead to innovation in sales and distribution methods; and, ultimately, result in improved and more specialized services and lower premiums (and thus lower costs to consumers) as banks and other providers target price-sensitive customers.

We believe banks may be particularly well-positioned to enhance consumer convenience. Authorizing depository institutions to act as insurance agents will add several hundred potential competitors with a distribution system including 5100 brick-and-mortar branch offices. Consumers will also benefit from being able to purchase life insurance products which include a savings or investment element from the same sources where they currently purchase traditional bank deposit products or execute securities investments. Similarly, consumers who require property and casualty insurance in connection with a loan for the acquisition or refinancing of property could (if Insurance Law Section 7-b is also repealed, as we recommend in Proposal No. 5 below) purchase their insurance at the same location as they obtain their credit.

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* The term "bank" here is used to mean commercial bank, savings bank, savings and loan association, and any other similar form of depository institution.

Furthermore, allowing banks to sell insurance through their existing branch network should provide a source of fee income for branch operations that would help, in part, to offset the elimination of the benefits formerly accorded by deposit interest rate regulation, and thus encourage banks to keep branches open in marginal banking communities.

We therefore expect substantial benefits to consumers if Proposal No. 1 is enacted into law. The Commission, however, heard considerable testimony in opposition to authorizing depository institutions to act as insurance agents or brokers. Advocates of excluding banks essentially made four arguments:

1. Because of the relative inequality of bargaining power between borrowers and banks, banks would be in a position to coerce consumers -- explicitly or implicitly -- into purchasing insurance from their own or affiliated agent or broker, to the disadvantage of independent agents and, possibly, consumers who might be able to obtain better terms elsewhere.

2. Because banks acting as agents will earn a premium from the sale of insurance, they will be motivated to select for sale products offering higher commissions, which

may be expected to also require the payment of higher premiums by the consumer (a tendency described as "reverse competition"), thus eliminating the anticipated benefits to the consumer of increased competition. This argument is supported by reference to the experience of banks and their affiliates in selling credit life, health and accident insurance.

3. Banks will not offer consumers the same level of services in connection with insurance products, resulting in a net decrease of consumer benefit for those who choose or are required to purchase insurance from a bank or its affiliated agent.

4. Because banks will seek to provide services with a minimum level of personnel, the entry of banks will result in a net decrease in employment in the agency and brokerage sector, even if banks hire individual agents or acquiring existing agencies or brokerages to enter this business.

We do not think these arguments justify continuing to exclude most banks from insurance agency or brokerage activities. However, in view of the significant number of witnesses at the Commission's public hearings who expressed these or similar views, we examine each of these contentions in some detail below.

1. Consumer Coercion

The argument most frequently advanced to the

Commission against permitting banks to act either as agents or brokers for the sale of insurance coverage is that banking institutions, by virtue of their power to grant or withhold credit sought by prospective borrowers, would be able to require such borrowers, if so permitted, to purchase their insurance coverage through their owned or affiliated agent or from their affiliated insurance company. (This argument was also advanced against allowing banks to underwrite insurance.) A common fear is that banks would explicitly ration credit or provide it on more favorable terms on the basis of insurance purchases. Another fear is of implicit or "voluntary" coercion: that a loan applicant would willingly place his insurance business with a bank-affiliated agent in hopes of improving his chances for a loan on favorable terms. Competition in the implicitly tied product, insurance, would be reduced to the degree that customers no longer made purchase decisions based on the economic merits of insurance alternatives. As a result, it is alleged, customers of banks would be required (or influenced) to purchase insurance that would be less advantageous in terms, or more costly, than coverage which they might choose to obtain from other competitive sources, and formerly independent agents could be forced out of business or into mergers with banks. This alleged phenomenon is often described as consumer "coercion" or the problem of "tie-in sales."

Preliminarily, it should be noted that this argument, whatever its validity (which will be discussed below), applies only to the sale of insurance by depository institutions to prospective borrowers, including credit applicants and those, such as businesses with continuous credit requirements, that must maintain an on-going credit relationship with a depository institution. The argument assumes that, because of the importance of the credit sought or the continuing credit relationship, these borrowers will not be able, or will believe themselves unable, to seek out the best available insurance product. Nothing in this argument, however, addresses itself to the question of whether depository institutions ought to be permitted to sell insurance, either as agents or underwriters, to persons other than prospective borrowers, including (perhaps most significantly) their depositors who are not also borrowers, or the general public, including customers of other depository institutions.*

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* No suggestion has been made, for example, that banks would refuse to accept deposits, or would offer depositors lower rates on their funds, in an effort, directly or impliedly, to require the purchase of insurance coverage. The reason that no such suggestion has been made, we believe, is obvious: there exists widespread and effective competition for deposits from both consumer and commercial customers, so that customers who are offered any such unattractive arrangement with respect to the deposit of their funds would, we believe, simply choose to place them with an institution which did not seek to impose unwanted or expensive insurance coverage. Similarly, we believe that the availability of alternative credit sources for most borrowers would make any supposed tie-in strategy unworkable.

We therefore conclude that, whatever the merits of this argument, banks ought to be able to sell insurance where no prospective credit relationship is involved.

Testimony and other materials received by the Commission in support of the tie-in sales argument have been submitted primarily (although not exclusively) by professional insurance agents and brokers, their representatives and counsel and representatives of trade associations of such individuals.* Representatives of consumer organizations who discussed consumer coercion** generally expressed the view that, to the extent that such coercion was a potential problem, it could be dealt with by regulation of the character recommended below and did not amount to a reason to exclude banks from acting either as agents or underwriters of insurance coverage.

The professional studies of the tie-in sales problem which were reviewed (see Section III.B of this report) suggested that, overall, the problem, to the extent it exists, is more one of consumer misperception which may reasonably be expected to be cured by adequate disclosure and other remedial measures, which we do propose (see below, Proposal No. 6), than it is one of industry structure which could only be addressed by maintaining strict barriers to entry. In addition, these studies point out clearly that the potential for such abuses may exist when any lender -- bank, finance company or retailer -- also sells insurance. Since each of these firms -- for example, the automobile salesman who arranges a car loan through a finance company and also sells the auto liability policy -- can act as an insurance agent under existing law, we see no strong policy argument for excluding only banks from this field.

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* The Commission also heard testimony on this point from a farmer, an independent trucker, the Mayor of a small up-state city and several academics.

** Robert Hunter of the National Consumer Insurance Organization; Marilyn Ondrasnik of New York Public Interest Research Group, Inc.; John Brown of the Washington-based Public Interest Research Group; and Richard Kessel of the State Consumer Protection Board.

In addition, existing laws and regulations already make most forms of tie-ins illegal. Section 7-a of our Insurance Law explicitly prohibits virtually all types of lenders, including most explicitly banks, from requiring the purchase of insurance in connection with a loan through a specified agent or from a particular insurer. To the extent that a few bank lenders today are not covered by Section 7-a, we recommend the statute be amended to cover them; to the extent the existing law is not being adequately enforced, we recommend additional enforcement mechanisms (see Proposal No. 6). Furthermore, Section 106 of the Bank Holding Company Act also explicitly prohibits banks from conditioning the granting or terms of credit on the customer's purchase of another non-banking service, including insurance, from the bank, its parent bank holding company or any other holding company subsidiary, and prescribes monetary penalties for both the bank and its officers and employees participating in violations of these requirements. Thus we find that significant legal protections against such abuses are already in place.

2. "Reverse competition"

Another argument sometimes advanced against authorizing banks to act as insurance agents is that they will select for sale products with higher, rather than lower, prices to consumers, in order to be able to earn the higher commission income presumably paid by the underwriter of the high cost policy. In theory, it is difficult to see how such a practice could persist if the market for insurance products were fully competitive and consumers had adequate information about the costs and terms of various policies, unless consumers were subject to the type of coercion previously discussed. If a product is widely available from competing providers, a particular provider should not be able to foist a higher-priced product on the purchaser unless the facts of the cost of the product and its ready availability from alternative sources is unknown. Neither a lack of cost comparison information nor ignorance of product availability should obtain in a market environment in which a range of competitors operate freely. Any tendency toward reverse competition which may be inherent in the agency system should be reduced, rather than aggravated, by the introduction of banks as additional insurance agents into the product delivery system.

Nonetheless, some opponents of authorizing banks to act as insurance agents argued that the experience to date with banks underwriting credit life insurance demonstrated that serious tie-in abuses or overcharging can be expected. Studies cited by representatives of independent insurance agents show that, in some cases, banks are able to achieve very high percentage of customers purchasing credit life insurance from a bank affiliate. These conclusions are consistent with the findings of the Federal Reserve study discussed earlier. However, high penetration rates by themselves do not prove that the sales of credit insurance were the result of explicit or implicit coercion, or indicate that "reverse competition" should be expected to occur in other lines of insurance offered by banks. Most purchasers surveyed by the Federal Reserve Board staff regarded credit life insurance as a desirable product, fulfilling its intended function of insuring repayment of the loan in the event of death or injury of the borrower. Notwithstanding that many banks have found the business to be highly profitable, perhaps unusually so, consumers did not generally regard the price of the product as too high. Probably, this is a result of the fact that premiums paid for credit life insurance are typically quite small in relation to aggregate loan payments. Thus, consumers do not regard the absolute cost as excessive, although it could well be that comparable coverage could be obtained at lower costs from other sources. The relatively small amounts involved provide little incentive for consumer comparison shopping and make the convenience of purchasing the coverage in connection with the loan a relatively more important factor than its price in comparison with alternative insurance coverage. Significantly, the small premiums involved also mean that independent insurance agents do not compete vigorously for the sale of such policies.

By contrast, typical premiums for ordinary life insurance and for homeowners' and automobile casualty insurance are more significant in amount and should provide greater incentive for consumers to seek out the most favorable price and terms. In addition, the more significant commissions payable with respect to such policies should be sufficient to ensure competition from independent providers, including other depository institutions as well as existing independent agents and brokers. Finally, credit life insurance is usually sold on a group basis, with the bank deemed to be the policyholder and entitled to receive any dividend

-- a factor which encourages reverse competition.* Since property and casualty insurance currently may not be sold on a group basis in this State (although the Insurance Department is considering such a proposal), the experience with credit life insurance is not directly relevant to consideration of authorizing banks to act as agents for these lines of coverage. We believe that, if abuses similar to those experienced in this State and others in connection with the sale of credit life insurance were to develop in the future in other lines sold by banks, they could be adequately dealt with by the Insurance Department by regulation similar to that adopted by the Department in 1980 to require minimum loss ratios for credit life underwriters. Therefore, we recommend in Proposal No. 6 below that the Insurance Department be granted stand-by authority to specify minimum loss ratios for other lines in similar cases.

3. · Customer Service

Nor do we find persuasive the argument that banks should not be granted additional authority to sell insurance because they will not provide adequate service to the insurance buying public. The assertion that all banks would not provide a full range of agency services is only partially correct: some banks, as well as other providers, probably would offer minimal service levels for the most price-sensitive customer, whereas others would offer more extensive and specialized services. As with other industries which have experienced deregulation, we expect there will be a wider range of service alternatives and that different banks, like other providers, will make a variety of decisions on appropriate price/service tradeoffs.

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* Revised Regulation 27-A promulgated by the Insurance Department prohibits the policyholder from retaining any dividends paid by the insurer. Both a lower court and the Appellate Division have held this provision to be invalid. The Department continues to enforce it, however, pending the outcome of its appeal to the Court of Appeals.

However, in the limited areas where banks or their affiliates have been authorized to sell insurance (SBLI, service corporations of thrifts, etc.), we believe they have provided competent professional service to their customers. We see no reason to believe that other banking institutions would not provide an equally satisfactory level of service, if permitted the opportunity. In some respects, banks may be expected to provide superior service because of their incentive to maintain the customer's banking or credit relationship.

Many banks have shown -- through installation of automated teller machines, telephone billpayer services and home banking experiments -- that they can devise means to serve their customers even during non-traditional business hours and away from the branch premises. In any event, those banks that do not provide the consumer with whatever level of service he or she demands are not likely to succeed in the insurance agency business.

4. Adverse Economic Consequences

A final argument advanced by those opposed to bank entry into insurance agency activities is that banks, by virtue of their resources, competitive advantages and experience with data processing and other modern business techniques, will dominate the insurance agency business, thereby driving out of business a substantial number of independent insurance agents and brokers. We recognize that bank entry into insurance sales may result in a lessening of employment opportunities for independent insurance agents. This is true for any industry subject to a reduction in entry barriers. However, fears of loss of market position or of loss of jobs in a protected sector of the economy should not stand as a bar to regulatory changes which would provide new jobs in another sector and would enhance competition and have beneficial effects for consumers.

Despite general claims that banks would drive independent agents out of the market for the sale of insurance products, the Commission was not presented with any evidence that attempted to quantify the allegations that the net effect of bank entry would tend to reduce employment within the State on an aggregate basis. Of course, banks will not be able to act as insurance agents without any employees whatsoever. To the extent that they are able to perform the traditional agency function more efficiently than independent agents, they may do so with fewer employees, and thus initially eliminate some jobs in the agency sector. However, strategies of individual banks will undoubtedly vary, and some may choose to employ former independent agents or acquire existing agency firms, seeking to expand market share against the direct-writers or other carriers. In addition, aggressive bank entry may have the effect of expanding the total market for insurance products within the State, thus increasing sales and supporting a higher level of employment. Alternatively, banks may succeed in packaging insurance sales with other products in such a way as to capture a greater share of the market for all financial services and leading to an increase in employment in the banking sector generally.

Insurance agents have so far survived the advent of the direct writers and the dramatic increase in the sale of group life insurance. Of course, the entry of any new competitor may result in the loss of business for another, and the dislocations that may follow, and the costs to the individuals involved, are proper concerns for public policy. However, we do not believe that the costs associated with a more competitive environment are an adequate basis for excluding banks from the insurance marketplace.

We therefore recommend that banks be authorized to act as insurance agent and brokers beginning next year. The January 1, 1985 effective date included in this proposal is intended to permit adequate time for banks to recruit staff for their new agency operations and to permit existing agents and brokers, if they so desire, to negotiate service, lease, joint venture or acquisition arrangements with interested banks prior to the commence date of bank agency and brokerage activities.

Our proposal contemplates that banks would be permitted to sell insurance on the premises of their existing branches, as well as at other locations. Although the Commission received and considered suggestions that banks be required to conduct any insurance sales activities only at separate locations in order to minimize the potential for consumer coercion, we concluded that such a rule would involve eliminating a significant portion of the convenience to consumers sought to be obtained by authorizing bank agency activities. Such a requirement could also create additional costs that would either have to be absorbed by banks or incorporated into the price of services to consumers. In view of the extensive remedies proposed against the possibility of coercion of borrowers by banks with respect to the sale of insurance (see Proposal No. 6 below), prohibiting sales at branch office locations does not seem to be necessary. In-branch sales, on the other hand, should make possible economies of scale in the insurance distribution function which ultimately may enable banks to accept lower commissions and negotiate lower rates with insurance underwriters.

Proposal No. 2

Beginning in 1985, all types of banks should also be authorized to own, manage and control subsidiary corporations which act as insurance agents and brokers. Thrift institutions which are currently authorized to engage in such activities through service corporation subsidiaries should be permitted to continue to do so in 1984. Both commercial banks and thrifts should be limited as to the amount which they can invest in such insurance agency subsidiaries, in a manner similar to the current limitation which now applies only to thrift institutions (which is currently 3% of assets for equity investments).

Discussion

We do not perceive any significant policy distinction between banks acting as insurance agents directly or acting through corporate subsidiaries. In either case, the consumer is likely to identify the agency with the bank and to regard them as part of a single enterprise. Similarly, there is no apparent significant difference in the risk involved to bank capital, which appears to be small for all types of agency activities. The proposed limitation on investments by commercial banks in service corporations engaged in insurance agency activities is intended to conform their authority to that now possessed by thrift institutions, which currently are authorized to invest up to an amount equal to 3% of their assets in service corporations. A similar limitation of 2% of 3% of assets on commercial banks is appropriate to avoid giving an advantage to one or more types of depository institutions with respect to their ability to engage in insurance agency or brokerage activities. In addition, since some brokers are quite large, an investment limitation is also appropriate for prudential reasons.

Proposal No. 3

Banks which act as insurance agents or brokers should be licensed and subject to regulation by the Insurance Department in the same manner as are other agencies, and the sale of insurance by banks and their affiliates should be conducted only by individuals who are so licensed and regulated.

Discussion

The Commission strongly endorses the concept of "regulation by function" -- that the separate activities of multi-service financial firms should be supervised and regulated by the appropriate state authority depending on the nature of the activity -- rather than by the primary regulator of the institution, which is often determined by the nature of its charter rather than by the actual types of activities in which it is engaged. Thus, the Commission firmly believes that the insurance agency activities in which banks may be authorized to engage should be supervised by the Insurance Department, and that the individuals engaged in insurance sales should be licensed and examined in the same manner and subject to the same rules which now apply to insurance agents generally. Personnel employed by banks or by an affiliated or subsidiary corporation to engage in insurance sales or brokerage activities should be required to take the same courses, pass the same examinations, and comply with the same licensing requirements as independent agents. In addition, the bank and/or its affiliate should be subject to all the provisions under the Insurance Law applicable to agents and/or brokers, depending on the nature of the business actually pursued. To simplify regulation and examination, the Commission contemplates that many banks may wish to form separate corporations to become licensed as agents.

Proposal No. 4

During a transition period of three years from the initial effective date (January 1, 1985) of legislation authorizing banks to act as insurance agents and brokers, each office or other location at which a bank offers insurance for sale to the public should be under the supervision of an agent, located on the premises, who has been licensed by the Insurance Department for at least three years and has three years of actual experience as an agent. This requirement would not apply to savings banks which limit their insurance activities solely to the sale of savings bank life insurance.

Discussion

The Commission received considerable testimony to the effect that banks, if authorized to engage in insurance agency activities, might be tempted to do so with untrained, or hastily-trained, personnel. Although the Commission does not believe that it would be in the interest of banks to do so, it does consider that an appropriate transition period, requiring each office or location at which a bank engages in insurance agency activities to be supervised by an experienced agent, is appropriate. Therefore, the Commission recommends that, during a three-year transition period commencing on the date (January 1, 1985) on which banks are authorized to act as insurance agents, insurance sales activities at a branch or other bank location be under the on-site supervision of an agent having at least three years of experience. This requirement should be sufficient to discourage banks from initially attempting to enter the business without experienced personnel, and would also offer employment opportunities for a number of existing agents. Since we contemplate that the three years of experience required of the supervising agent would match the three-year transition period, banks would be able to train their own personnel to a comparable level of experience during this period. This proposal would also have the effect of prohibiting off-hours sales of insurance policies through the equivalent of automatic teller machines during the transition period, unless an agent was available on the premises to deal with consumer inquiries.

Since savings banks, however, have long experience with the sale of savings bank life insurance, this requirement should not apply to savings banks which limit their sales activities solely to SBLI.

Proposal No. 5

Effective January 1, 1986, Section 7-b of the Insurance Law -- which prohibits an agent controlled by a bank from writing property and casualty insurance on property which is the subject of, or collateral for, a loan -- should be repealed. Concurrently, however, Sections 117 and 119 of the Insurance Law should be amended to make clear the authority of the Superintendent of Insurance to suspend or revoke the authority of a bank or other lender to act as an insurance agent or broker upon a finding that it has engaged in an anti-competitive practice (including any violation of Section 7-a of the Insurance Law) in the sale of insurance in connection with the making of loans.

Until the effective date of the repeal of Section 7-b, its provisions should be made uniform so as to apply to certain lenders (including federally-chartered stock savings banks, non-New York thrift institutions and securities firms) which may offer insurance in connection with property loan transactions.

Discussion

Although Proposal No. 1 recommends that banks be authorized to act directly as insurance agents and brokers, the ability of banks to do so in a meaningful way would be severely limited by the provisions of Section 7-b of the Insurance Law. This section prohibits any insurance agent or broker that is owned or controlled, directly or indirectly, by a bank from negotiating any policy of insurance covering either real or personal property which is the subject matter of, or security for, a loan or extension of credit made by the bank. For example, if banks were authorized to sell insurance but Section 7-b were left intact, banks would nonetheless be prohibited from offering such policies as homeowners' insurance in connection with mortgage loans made by the bank and automobile insurance on vehicles which were financed by the bank. Excluding banks absolutely from the sale of these types of insurance would represent a considerable lessening of the convenience sought to be obtained for consumers, and would eliminate banks from markets with which they would be particularly familiar because of their knowledge and inspection of the property involved. The Commission believes that consumers would be better served by being able to choose to purchase insurance from bank-affiliated agents and brokers, subject to appropriate safeguards of the type recommended below, rather by a continuation of the absolute bar of Section 7-b. We therefore recommend that this statute be repealed, effective one year after banks are first authorized to act as insurance agents (which would be January 1, 1986 in accordance with Proposal No. 1).

The predecessor of Section 7-b was enacted in 1971 for a one year trial period, was subsequently renewed on a number of occasions and finally was enacted on a permanent basis in 1977, following a study by the Superintendents of Banks and Insurance, the Executive Director of the Consumer Protection Board and the Chairmen of the Senate and Assembly Insurance Committee. Since 1977, however, rapid developments have taken place in the financial services industry. Of particular significance in this context are the pressures on banks' earnings caused by the repeal of Regulation Q, and the ability of securities firms, insurance companies and financial conglomerates, all competitors of banks, to offer a wide range of services including both near banking services and the sale of property and casualty insurance. As a result, banks that today cannot offer a wide range of services to their customers are placed at a competitive disadvantage. This generally was not the case prior to 1977.

In addition, the conclusion of the 1977 report (from which the then Acting Superintendent of Banks dissented) was predicated in large measure on fear of undue coercion of prospective borrowers by banks selling property insurance. This portion of the report, however, was not supported by any consideration of evidence of actual or even potential abuses. Two years later, however, the Federal Reserve Board completed its 1979 study of insurance sales by various types of lenders and, as described earlier in this report, found little evidence of coercion by banks. Since Section 7-b has been in effect in New York for more than a decade, there is little other experience to draw on in this State. In an effort to determine the actual extent of the tie-in problem in other states, the Commission staff wrote to 31 insurance commissioners or departments in those states that do not have prohibitory legislation comparable to Section 7-b. Of the 13 states responding, only one reported the actual filing of complaints, which ultimately led to only one hearing. To the contrary, several states specifically reported no evidence of undue influence being exerted on loan borrowers.

The 1977 report on Section 7-b conceded that "it may be possible to develop regulations which would, in theory, mitigate the occurrence or effect of such coercion," but concluded that "the problem lies in the enforcement of such regulations." We believe the extensive prophylactic measures recommended in the following proposal should more than adequately deal with the perceived problem of debtor coercion. In addition, we are also recommending, in Proposal No. 26, that the Insurance Department and the Division of the Budget review the Insurance Department's budget and operating procedures in order to better utilize the Department's resources in light of the additional responsibilities which would be imposed by our proposed system of regulation. We believe the Superintendent of Insurance and the New York State Insurance Department's competent staff will be able to effectively supervise banks' sale of insurance in connection with extensions of credit. Finally, we propose that existing law be amended to make clear the power of the Superintendent to suspend or revoke the authority of a bank or other lender to act as an insurance agent or broker upon a finding that it has engaged in an anti-competitive practice (including any violation of Section 7-a of the Insurance Law) in the sale of insurance in connection with the making of loans.

Because we propose that the repeal of Section 7-b not take place until January 1, 1986, there would be a period of a year or more during which certain institutions that now offer property insurance in connection with property loan transactions would not be governed by the provisions of Section 7-b. This discrepancy results from the definition of "bank" in Section 7-b, which, while very broad, does not include federally chartered stock savings banks, non-New York thrift institutions and securities firms. Unless further action is taken, therefore, until the repeal of Section 7-b, these institutions would have a competitive advantage over those banking institutions that remain subject to this prohibition. Therefore, we envision the enactment of legislation which, until January 1, 1986, would broaden the scope of the statute to apply to all such lenders pending its eventual complete repeal on such date.

Proposal No. 6

A variety of measures should be adopted to discourage the possibility of coercion of insurance consumers by banks and other lenders, including: requiring lenders who sell insurance to offer policies which provide a 30-day cancellation privilege; prohibiting lenders from soliciting insurance from prospective borrowers prior to approval of their credit application; strengthening Section 7-a of the Insurance Law; and requiring improved disclosure to consumers.

Discussion

As indicated above, the Commission does not believe that the possibility of consumer coercion or "tie-in" sales by banks acting as insurance agents or brokers is sufficient reason to prohibit them by law from engaging in these businesses. However, the Commission recognizes that such abuses are possible for a variety of reasons and may occur and that, regardless of the actual extent of abuse, many consumers initially may feel (as indicated in the Federal Reserve Board's staff study), that the purchase of insurance coverage from their bank is highly advantageous or even required in connection with other banking transactions. This possibility appears particularly of concern in connection with loan applications to purchase property for which insurance coverage is required by the lender in accordance with the terms of the loan or mortgage. Such explicit or implied coercion is disadvantageous to consumers in that it may discourage them from seeking out the best price and terms for the insurance that they require and may lead them to accept inferior or more expensive coverage which is being sold by the bank, its affiliate or employees. As indicated by the study prepared for the American Insurance Association, the possibilities of such practices are likely to be greater in communities where consumers have the least choice among financial institutions, in smaller banks which may attract less publicity to their practices and with less educated consumers who may be unfamiliar with their rights and the availability of alternative sources of insurance, including independent agents and direct writing companies.

The Commission believes that if banks, as well as other lenders, are to be authorized to act as insurance agents and brokers, the opportunity and possibility for consumer coercion must be strictly limited and policed. Therefore, the Commission recommends adoption of a variety of procedures designed to encourage consumers who are applying for credit to seek out the best available insurance coverage and give them the opportunity to do so without explicit or implicit coercion. The measures we propose are the following:

1. Requiring banks and other lenders which sell insurance to offer the consumer a policy which allows the consumer to cancel the coverage during an initial 30-day period upon payment of only one month's premium.

2. Prohibiting banks and other lenders from soliciting insurance to cover an extension of credit, or to insure property which is the subject of, or security for, a loan, until after a credit commitment in writing has been issued.

3. Strengthening Section 7-a of the Insurance Law by requiring banks and other lenders to accept substitute policies meeting their minimum standards during the 30-day cancellation period referred to above, and to prohibit certain anti-competitive practices in connection with renewals of outstanding policies.

4. Requiring banks and other lenders which act as insurance agents or brokers, or do so through an affiliate, to provide their customers a standardized disclosure form that would spell out the customer's rights under the law and clearly describe the 30-day cancellation period and the terms of any insurance being offered by the lender.

5. Giving the Insurance Department increased powers to deal with cases of tie-in sales that may still arise.

These proposals are discussed in further detail below.

(a) Thirty-day cancellation period

The first proposal would require a bank or bank-affiliated insurance agent offering insurance to a prospective borrower to offer the consumer only a policy which includes a 30-day period during which the consumer may cancel the coverage without penalty upon payment of not more than one-month's premium. Since the terms of many common insurance policies (for example, the standard homeowners' and automobile policies) are prescribed by statute, this change would require enactment of amendments to the Insurance Law to prescribe a type of policy which includes such a cancellation period and to clarify that the consumer would be required to pay only a pro-rated portion of the annual premium, rather than the higher rate which normally applies to short-period coverage. Under this policy, it is intended that the consumer be fully covered by the insurer during the period between the initial policy date and the date of cancellation* and that the insurance would automatically continue in effect unless the consumer gave notice of cancellation to the insurer during the 30-day period. Because competing insurers (including other banks) will have the opportunity to advertise their rates and because consumers would receive a written disclosure informing them of their right to make alternative arrangements during the 30-day period, the cancellation period should give consumers ample opportunity to seek out better coverage, if it is obtainable, and to substitute it without cost. As a practical matter, the Commission anticipates that the existence of such a statutory cancellation right should act as a significant deterrent to "reverse" competition, that is, the tendency of insurance agents to select for sale to their customers a policy paying the agent high commissions rather than one offering the lowest premium to the purchaser.

Although this proposal would require that policies offered by banks and their affiliated insurance agents contain such a 30-day cancellation clause, the statute should also authorize other property and casualty companies, not affiliated with banks, to offer policies containing such a term. The Commission anticipates the possibility that such a cancellation clause would be popular with consumers, and believes that independent, non-bank affiliated insurers should be able to offer such an option to their customers as well, if they so desire.

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* Since cancelled policies will entail costs to the insurer, it may be expected that insurers and banks will make arrangements for the agent banks to bear these costs or to share them with the underwriters. In the ordinary case, the consumer should not be required to pay any more than a pro-rated share of the annual premium.

(b) Prohibition on solicitation

We also propose that lenders and their affiliated insurance agents should be prohibited by statute from soliciting the sale of insurance coverage to a prospective borrower until after the borrower's credit application has been approved in writing by the lending institution. This rule would apply both to traditional credit insurance (which insures the bank for the repayment of the loan in the event of the borrower's death, injury or, in some cases, involuntary unemployment) and to credit-related property and casualty insurance (for example, insurance covering a home or automobile which is the collateral for a loan). The testimony received and other evidence examined by the Commission indicates that the potential for consumer coercion is greatest if the sale of insurance is suggested or solicited at a time when the consumer is in doubt as to whether or not he will receive a loan for which he has applied. Postponing the insurance sale until after the credit application has been approved should eliminate this concern by enabling the consumer to consider the insurance for a period of time, secure in the knowledge that his credit approval has been obtained. We recognize that this rule will limit, to some extent, the convenience of obtaining insurance in connection with loan transactions at the same time and in the same location as the credit transactions are completed. However, we believe that subsequent solicitations by mail or telephone between the time of credit approval and disbursing of the loan should afford both the customer and the lending institution opportunity to complete the insurance transaction.

Once a loan has been approved, and after it has been made, there would be no limitation on the ability of the bank or other lending institution to solicit the consumer for renewal of his outstanding policies, subject to the requirements of Section 7-a as proposed to be amended as described in the following paragraph.

(c) Amendments of Insurance Law Section 7-a

Section 7-a of the Insurance Law currently prohibits all types of lenders from requiring borrowers to negotiate a policy of insurance through a particular agent or to obtain an insurance policy from a specified insurer. The Commission believes this provision of law is appropriate and should be maintained, and recommends expanding the statutory language to specifically require lenders to accept any policy meeting the lender's objective minimum requirements from any licensed insurance company during the 30-day cancellation period described in paragraph (a) above. Such a provision is desirable to limit the possibility that the intention of the 30-day cancellation period would be frustrated by lenders refusing to accept substitute policies, thus leaving the consumer with no practical choice but to keep the original coverage obtained through an affiliate of the lender or risk becoming uninsured.

In addition, we recommend that Section 7-a be amended to specifically prohibit lenders, including banks, from refusing to process annual renewals of insurance policies, refusing to promptly forward to the insured or his broker notices of premiums due, refusing to pay annual premiums from escrow accounts where the payment is to be made by the lender, and other such practices where the borrower's insurance policy was issued by an insurance company or obtained through an agent which was not affiliated with the bank, or in an attempt to induce the customer to purchase a new policy through a particular agent or from a particular insurance company, including one affiliated with the bank.

Finally, Section 7-a should be amended to prohibit lenders from charging unreasonable fees to any non-affiliated insurer, agent or broker in connection with the substitution of an insurance policy, expanding the current prohibition against fees charged to the property owner or mortgagor. The Superintendent of Insurance should be authorized to prescribe a reasonable minimum fees which might be charged in connection with policy substitutions.

(d) Disclosure to Consumers

A further significant safeguard against coercion of consumers should be to require each lender which acts as an insurance agent or which is affiliated with an agent, broker or underwriter and which requires or solicits loan customers to obtain insurance coverage to provide to consumers a standardized disclosure form which would set forth the consumer's rights in accordance with the foregoing provisions and other matters relating to the proposed insurance coverage. Such a disclosure form should include, at the minimum, the following provisions:

> 1. A summary of the provisions of Section 7-a of the Insurance Law to the effect that, if the customer is required to obtain insurance, he is not required to purchase his coverage from the lender or any specified insurer or agent.
>
> 2. A statement that the lender is not permitted to solicit insurance in connection with a credit transaction until after the borrower's application has been approved.
>
> 3. That the type of insurance that may be required is available directly from insurance companies and from other insurance agents and brokers.
>
> 4. That any policy of insurance provided through an affiliate of the lender must contain a clause permitting the customer to cancel the policy during the initial 30-day period.

5. A disclosure of the price and material terms of any insurance coverage being offered by the lender or its affiliate.

6. The address and telephone number of the appropriate claim bureaus in the Insurance Department and the Department of Law.

The importance of adequate disclosure to consumers was emphasized by many consumer representatives who testified before the Commission. Particularly helpful to the Commission were the recommendations received from Richard M. Kessel, Executive Director of the State Consumer Protection Board. In accordance with Mr. Kessel's suggestions, the Commission recommends that prospective borrowers be notified of their right to obtain insurance coverage from a provider of their choice and of the prohibition against soliciting insurance coverage prior to approval of the credit application (items 1 and 2 above) as part of the credit application itself. In addition, we agree with Mr. Kessel that the other required disclosures should be furnished to the consumer no later than the time that he is first solicited for insurance by the lender or affiliated agent or insurer. To emphasize the importance of these disclosures and provide a record of compliance with these provisions, the disclosure form(s) should be signed by both the customer and the lender or its affiliated agent.

Finally, the Insurance Department, in consultation with the State Consumer Protection Board, should be authorized to prescribe a standard form of disclosure for all banks selling insurance and all bank-affiliated agents.

(e) Additional Enforcement Powers

In order to provide greater assurance that banks and other lenders who enter the insurance business will comply with the requirements described above, we recommend that the Insurance Department strengthen its enforcement mechanism with respect to violations of Section 7-a of the Insurance Law and the new provisions we recommend be enacted as described above. In particular, we encourage the Insurance Department to monitor compliance by lenders with these requirements by employing a number of field examiners who would test lenders' procedures by posing as prospective borrowers and insurance customers. Although we recognize that such enforcement methods may be distasteful to some, it is apparently the case that very few consumers, for whatever reason, complain of violations of Section 7-a or are willing to assist the Department in prosecuting violations when they are discovered. Since individual consumers may not have a sufficient financial interest to pursue claims, the burden of enforcing these provisions must fall most heavily on the Insurance Department.

In addition, we recommend that legislation be enacted giving the Insurance Department authority to prescribe minimum loss ratios and/or maximum rates for property and casualty insurance underwritten by an insurer which is controlled by a bank or other lending institution on property which is the subject of, or security for, a loan or extension of credit provided by the bank if, after an administrative proceeding, the Department finds that loss ratios for such coverage have become unreasonably low or rates have become excessive and unfair to consumers. This authority would not apply to independent property and casualty insurance companies, but only to those controlled by banks or other lenders. The experience with credit life insurance premium rates in this and other states suggests that there may be some tendency, at least in the case of credit insurance, for banks to charge excessive premiums. In view of the numerous safeguards recommended above, we do not believe this experience is likely to be repeated with other lines of insurance. However, if cases of abuse do recur, the Department should have statutory authority to act by requiring minimum loss ratios as it has for credit insurance under its Regulation 27A.

Proposal No. 7

In addition to the power granted to the Insurance Department to suspend or revoke the agency authority of a bank for violations of the anti-tie-in provisions, the Superintendent of Insurance should have the authority to obtain injunctive relief pursuant to Section 35 of the Insurance Law and authority to request the Attorney General to maintain a civil action in the name of the people of the state (or intervene in an action brought by policyholders) for the recovery of treble damages or, where actual damages are nominal or impossible to ascertain, a specified statutory penalty, or for other appropriate equitable relief.

Discussion

Proposal No. 5 would empower the Superintendent of Insurance, upon a finding that a bank has engaged in anti-competitive practices in the sale of insurance in connection with a credit transaction, to suspend or revoke the authority of a bank to act as an insurance agent or broker. Although the Insurance Law grants the Superintendent of Insurance authority to obtain injunctive relief pursuant to Section 35 of the Insurance Law and to impose and enforce monetary penalties (*e.g.*, Sections 5 and 36), there is no specific statutory authority for the Superintendent to obtain other kinds of equitable relief. There is precedent in other areas of the Insurance Law, however, for the Superintendent, upon a finding of wrongdoing, to request action by the Attorney General. For example, Section 69-j(2) provides that the Superintendent, after a determination that a policyholder or an insurer has suffered loss or damage by a member of a holding company, may request the Attorney General to maintain a civil action to recover damages or for other appropriate relief. Accordingly, we recommend that the Attorney General, upon request of the Superintendent of Insurance, be given the authority to maintain a civil action in order to recover treble damages (or, where actual damages are nominal or impossible to ascertain, a specified statutory penalty), or to obtain equitable relief other than injunctive relief, to ensure that the public is protected against possible coercion or tie-in sales in the sale of insurance which is related to the extension of credit. In addition, we recommend that the Attorney General have the authority to intervene in an action brought by policyholders against an agent or broker owned by a bank where the subject matter of the suit involves anti-competitive practices in the sale of such insurance products.

STATEMENT

OF THE

ALLIANCE OF AMERICAN INSURERS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ON THE

"SOUTH DAKOTA LOOPHOLE"

SEPTEMBER 11, 1985

We thank you for the opportunity to submit this statement. The Alliance of American Insurers is a national trade association with over 175 members that provide property/casualty insurance protection to all 50 states and the District of Columbia. Believing that states should not be permitted to entice bank holding companies to violate federal law, we urge this Subcommittee and the Congress to definitively close the "South Dakota loophole" by enacting the language in Section 2 of Chairman St Germain's bill, H.R. 1513.

The "South Dakota loophole" is, of course, an attempt by one state and several aggressive bank holding companies to evade the clear purpose and requirements of the Bank Holding Company Act ("BHCA"). Congress in 1982 reaffirmed the fundamental national policy behind the separation of banking and insurance when it clarified Section 4(c)(8) by enacting Title VI of the Garn-St Germain Act. In doing so, it made it explicit that, except in strictly limited circumstances, bank holding companies are not permitted to engage in the insurance business. Citicorp and the State of South Dakota, however, developed a plan to circumvent the plain language and intent of the BHCA. South Dakota decided to allow out-of-state bank holding companies to buy South Dakota-chartered banks that would be empowered to sell and underwrite insurance everywhere in the United States -- except in South Dakota. And

Citicorp argued (before the Federal Reserve Board) that the BHCA did not authorize the Fed to regulate state-chartered non-member banks and their subsidiaries, and therefore it could enter the insurance business through a state-chartered bank. By going through South Dakota, Citicorp contended, it could do what federal law strictly forbade it from doing.

Fortunately, the Board protected the integrity of the Bank Holding Company Act by rejecting Citicorp's application to buy its South Dakota bank. The Fed did not, however, explicitly base its ruling upon its clear power to regulate state-chartered banks that are part of a bank holding company system (although its ruling implicitly upholds that power). Instead, the Board concluded that South Dakota's attempt to attract jobs and money to South Dakota by allowing Citicorp to engage in the insurance business everywhere except South Dakota was designed to evade the BHCA, and is thus illegal under Section 5. Its ruling, however, rests implicitly upon the fact that the Fed can regulate state-chartered banks and their subsidiaries that belong to bank holding company systems to the extent of ensuring that they are not engaged in activities that violate the BHCA. Although we believe that this is the law now, it should be explicitly endorsed by the Congress. Otherwise, we must depend upon the courts and administrative agencies, some of which are committed to expanding bank powers as far (if not farther) than they can be expanded (such as the FDIC and the Comptroller of the Currency) to protect the Congress' intent. Otherwise we may also see the type of regulatory "race to the bottom" that South Dakota tried to start, in which states outdo each other to see who can entice most bank holding companies with the least regulatory restrictions. Such a competition could be disastrous both for banking and insurance regulation (witness the recent Ohio and Maryland S&L crises) and must be prevented. Section 2 of H.R. 1513 does this admirably, as does analoguous language in S. 716, proposed by Senator Mattingly.

In no way would this limit state sovreignty, nor does it affect the dual banking system. In fact, enactment of this language simply makes clear that the states cannot encourage the subversion of federal law. States will continue to be entirely unlimited in the powers they give to free-standing state-chartered banks. It would, however, make impossible the evasion of the BHCA's purposes through the mere purchase of a state-chartered bank with powers that the BHCA forbids to bank holding companies. State-chartered banks gain several advantages by entering or setting up bank holding company systems that are otherwise unavailable to them, including tax preferences and the avoidance of state law restrictions on branching and certain interstate activities. It is simply not right that state-chartered banks should be able to use the advantages of bank holding company status while avoiding the obligations thereof. Although we believe this is the law now, Congress should state so explicitly.

The Alliance is not opposed to competition. Our companies welcome it. But competition between banks and insurers must be restricted until the competing demands of bank and insurance regulation -- both of which are critically important to protect the public and each of which are very different -- can be reconciled. The need to ensure that state insurance regulators alone regulate insurers, that the public is protected from tie-in and other coercive sales, that insurance and bank insolvency mechanisms are protected and reconciled, as well as other equally-important concerns, cannot be met by allowing states to compete to see which one can permit the widest violations of federal law. If banks are ever to be allowed into the insurance industry, much more care must be taken than to do so through a back-door mechanism. The Fed has nearly closed that back door, and we ask this subcommittee and the Congress to lock it.

Chairman **St Germain**. I think, Mrs. Roukema was here before the others.

Mrs. **Roukema**. I have no questions for Mr. Partee, but I have enjoyed the exchange among our colleagues, and I certainly agree with the statements of Mr. Partee and his observations he has made today.

Chairman **St Germain**. Mr. McCollum?

Mr. **McCollum**. I just have one question.

Do you think we should address this South Dakota loophole question in a single separate piece of legislation? Is it such urgency we ought to do it that way or do you think we ought to take this in some comprehensive fashion when we consider a more sweeping safety-soundness change?

We are certainly looking at big and little around this place. Do you have any feelings about that?

Mr. **Partee**. I think that the problem of too many and too risky activities permitted by the States, and South Dakota is a leading example of that, is a very serious problem for the financial system, and therefore, I think it needs to be addressed.

Whether or not you people can best address these questions in one big global package or whether it is better to do it piece by piece is your business.

Mr. **McCollum**. My real question is the urgency of this, in your opinion, do you feel it has to be done very hastily, in some kind of expeditious fashion, or does it matter whether we do it this year or next year?

Mr. **Partee**. I think it ought to be done this year, because I think there will be more and more copying by other States through their legislative sessions. But I can't say that we need to have it done in September rather than December.

Mr. **McCollum**. Do you put this ahead of some of the other things you know this committee is considering? And there is quite a number on our plate, and you are quite involved. Just where—does this rate warrant special exception, or does it fit into the plan of what we are doing and we ought to get it done?

Mr. **Partee**. It is less important to us than some other things, such as a nonbank bank loophole, but on the other hand, it is something that needs to be done. And I wouldn't want to risk its being done by putting it into a large piece of legislation that might not in fact be completed.

Mr. **McCollum**. Thank you.

Thank you, Mr. Chairman.

Chairman **St Germain**. I am glad you asked those questions.

Mr. Parris?

Mr. **Parris**. Thank you, Mr. Chairman.

I have no questions.

Chairman **St Germain**. Mr. Bereuter?

Mr. **Bereuter**. No questions.

Chairman **St Germain**. Does anyone else on the subcommittee have any questions of Governor Partee?

If not, Governor, we want to thank you. This is probably one of the shortest appearances you ever had. But, you know, it is just as significant, and the quality was high.

Mr. **Partee**. Thank you very much, Mr. Chairman.

Chairman St Germain. Of course, I am not sure that I agree with everything you said, but it was excellent. Thank you, Governor Partee. If we have any further questions, we will submit them in writing.

Now, I would ask the throng to gather. You will be assisted by committee staff, who will line you up properly. The Chair will state that we have a very eminent panel here, some of whom we have seen before, some of whom are new, but we will start the testimony in conjunction with the printed witness list.

Our first witness—and I will say this for all of them—I ask unanimous consent that all of their statements go into the record as presented, and then we will call upon them for their oral presentations.

Is there any objection? The Chair hears none. We will now hear from Kenneth L. Roberts, chairman of the Association of Bank Holding Companies. Mr. Roberts?

STATEMENT OF KENNETH L. ROBERTS, CHAIRMAN, ASSOCIATION OF BANK HOLDING COMPANIES, ACCOMPANIED BY DONALD R. ROGERS, ASSOCIATION PRESIDENT

Mr. Roberts. Mr. Chairman and members of the subcommittee, I am Kenneth L. Roberts, chairman of the board and chief executive officer of First American Corp., a regional bank holding company headquartered in Nashville, TN.

I am also chairman of the Association of Bank Holding Companies, on whose behalf I am appearing this afternoon. With me is Donald L. Rogers, association president.

Our association is composed of approximately 165 members whose combined assets comprise about 70 percent of all commercial banking assets. We have members in most States, ranging in size from National Banking Corp. of Florida, Inc., with assets of just over $100 million, to BankAmerica Corp. and Citicorp.

I would say the most typical is organizations such as ours, which is a $4.2 billion regional bank holding company.

The issue today, of course, is the South Dakota issue. Before doing so, I want to commend you and Congressman Wylie and this committee on another matter, and that is bring forth with your leadership H.R. 2707, which we feel is progressive legislation. Although we don't agree with all the subsidiary issues in it, we did want to make that comment.

Now, with respect to the South Dakota issue, and the principal issue there is the exporting of insurance services from a small State-chartered bank out of State. We feel that issue has now been made moot by the order of the Federal Reserve Board, and therefore we believe that no further action is needed by Congress, nor is it justified.

In our view, it is unfortunate that Congress continues to devote time to proposals that would limit bank holding companies' ability to sell insurance. This controversy has been around at least since 1969, when the House Banking Committee was considering the one bank holding company bill.

There have been numerous hearings, mark-ups, debates, and so forth, that have ensued since then, all with the avowed purpose of limiting the type of insurance that bank holding companies may sell.

These initiatives have received no support from consumer groups, the bank regulatory agencies, the Federal Trade Commission or the Justice Department. The principal support for these kinds of issues has derived from the insurance industry itself, notably the groups represented at this hearing, and it is perhaps understandable then, in spite of the millions of dollars the insurance industry has poured into the battle to keep banks out of the insurance business, their only success has been the enactment in 1982 of title VI of the Garn-St Germain Act.

Title VI, while regarded as a victory by the insurance industry, in fact is riddled with exceptions and exemptions which taken together, suggest a reluctance on the part of Congress to completely foreclose bank holding company insurance sales.

What title VI accomplished in actuality was to grandfather the insurance activities of any of our association's member companies, and to deregulate to the insurance powers of thousands of bank holding companies having assets of under $50 million.

Moreover, national banks and all bank holding companies can sell any type of insurance in towns under 5,000 in population, finance company subsidiaries, sell property insurance on credits of insurance and another 16 larger bank holding companies that had active insurance operations prior to January 1 were granted special privileges.

Furthermore, title VI left untouched mutual savings banks, savings and loan associations, credit unions, independent finance companies and others, all of which actively sell credit related insurance.

It is clear to us, in enacting title VI Congress actually endorsed the mixing of credit and insurance for thousands of bank holding companies, and moreover, the results of title VI showed that Congress was right.

The provision of a mixture of financial services, including insurance agency activities by smaller bank holding companies has had no ill effects. This afternoon, however, we see the pressure from the insurance industry is not abated. We are here for the purpose of discussing yet another loophole, this having to do with insurance powers permitted State-chartered banks.

H.R. 1513 introduced by the Chairman, attests to the fact Congress has not seen fit in the Bank Holding Company Act to interfere with the bank chartering, regulatory and supervisory authority of the various States.

This bill, however, H.R. 1513, would do just that. The clear purpose of H.R. 1513 is to prohibit the exporting of insurance services by a bank. However, this issue was resolved by the Federal Reserve Board.

The difficulty is that H.R. 1513 would even apply the same nonexport stricture on insurance activities to all State-chartered banks, not just holding company subsidiaries, and also place export restrictions on other financial activities engaged in by State banks.

This is the area that goes directly to the heart of the dual banking system, directly to the heart of the States' rights, and really deserves a hearing on its own.

Today, we have a situation where only larger bank holding companies in this country are precluded from mass marketing insurance to consumers. I would point out the average commission earned by an independent agent on personal lines ranges from 15 percent on up.

If bank holding companies could freely enter the property and casualty insurance market, we would be able to offer the same insurance products at lower cost, resulting in savings of at least 5 to 10 percent or more to the consumer.

Thus, in a large market such as New York State, potential savings to consumers are in the tens of millions. I think this is one reason why the temporary Commission on Banking Insurance and Financial Services in New York State has recommended the State's laws be changed to allow banks to sell insurance.

The bottom line, Mr. Chairman, is that consumers across the country are missing an opportunity to save millions of dollars because of the remaining constraints on bank holding company sales of insurance.

The deregulatory process that title VI actually started should be continued so that all bank holding companies, regardless of size, are in fact able to sell insurance of all kinds.

This concludes my oral statement, and I will be happy to answer any questions members of the committee may have.

[The prepared statement of Mr. Roberts on behalf of the Association of Bank Holding Companies follows:]

Statement of
Kenneth L. Roberts
Chairman
Association of Bank Holding Companies
before
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
House of Representatives
Washington, D.C.
September 11, 1985

Section I--Oral Statement

Mr. Chairman and members of the Subcommittee, I am Kenneth L. Roberts, Chairman of the Board and Chief Executive Officer of First American Corporation, a regional bank holding company headquartered in Nashville, Tennessee. I am also Chairman of the Association of Bank Holding Companies, on whose behalf I am appearing this afternoon. With me is Donald L. Rogers, Association President.

Our Association is composed of approximately 165 members whose combined assets comprise about 70 percent of all commercial banking assets. We have members in most states, ranging in size from National Banking Corporation of Florida, Inc., with assets of just over $100 million, to BankAmerica Corporation and Citicorp. First American, with total assets of just over $4.2 billion, is typical of the Association's membership of mainly regional bank holding companies. We own seven banks and have affiliates engaged in investment advisory services, commercial finance, and credit life insurance underwriting.

As I discuss later in this statement, the most controversial aspect of the South Dakota "problem" —namely, the exporting of insurance services from a small, state-chartered bank out of state—has been mooted by a recent order from the Federal Reserve Board. No further action by Congress is needed nor is it justified.

It is unfortunate that Congress continues to devote time to proposals that would limit bank holding companies' selling insurance. This controversy has been around at least since 1969, when the House Banking Committee was considering the "one-bank" holding company bill. Numerous hearings, mark-ups, debates and so forth have ensued since then, all with the avowed purpose of limiting the types of insurance bank holding companies may sell. These initiatives have received no support from consumer groups, the bank regulatory agencies, the Federal Trade Commission or the Justice Department—in other words, from experts on markets and competition. The principal support for them has derived from the insurance industry itself, notably the groups represented at this hearing.

It is perhaps understandable, then, that in spite of the millions of dollars the insurance industry has poured into the battle to keep banks out of the insurance business, their only "success" has been the enactment in 1982 of Title VI of the Garn-St Germain Act. Title VI, while regarded as a victory by the insurance industry, is riddled with exceptions and exemptions which, taken together, suggest a reluctance on the part of Congress to entirely foreclose bank holding company insurance sales. What Title VI accomplished, in actuality, was to "grandfather" the insurance activities of many of our Association's member companies, and to deregulate the insurance powers of thousands of bank holding companies having assets of under $50 million. Moreover, national banks and all bank holding companies can sell any type of insurance in towns under 5,000 in population; finance company subsidiaries of bank holding companies can sell property insurance on extensions of credit up to $10,000 (or $25,000 in the case of mobile homes); and another 16 larger bank holding companies that had active insurance operations prior to January 1, 1971, were granted special privileges. Furthermore, Title VI left untouched mutual savings banks, savings and loan associations, credit unions, independent finance companies, etc., all of which actively sell credit-related insurance.

It is clear that in enacting Title VI Congress endorsed the mixing of credit and insurance for thousands of bank holding companies. Moreover, the results of Title VI since its enactment show that Congress was right--the provision of a mixture of financial services, including insurance agency activities, by smaller bank holding companies has had no ill effects.

This afternoon, however, we see that the pressure from the insurance industry has not abated. We are here for the purpose of discussing yet another so-called "loophole" in Title VI, this having to do with insurance powers permitted state-chartered banks. H.R. 1513, introduced by Chairman St Germain, attests to the fact that Congress has not seen fit, in the Bank Holding Company Act, to interfere with the bank chartering, regulatory and supervisory authority of the various states. H.R. 1513, however, would.

One clear purpose of H.R. 1513 is to prohibit the "exporting" of insurance services by a bank. However, this issue was resolved by the August 1 decision of the Federal Reserve Board denying an application of Citicorp to purchase a bank in South Dakota, which I discuss in section 2. H.R. 1513 would even apply the same non-export stricture on insurance activities to all state-chartered banks, not just holding company subsidiaries, and also place export restrictions on other financial activities engaged in by state banks. These proposals deserve a hearing of their own.

Today, only larger bank holding companies are precluded from mass-marketing insurance to consumers. The average commission earned by an independent agent on personal lines ranges from 15% on up. If bank holding companies could freely enter the property and casualty insurance market, we would be able to offer the same insurance products at lower cost--resulting in savings of perhaps 5% to 10% or more. Thus, in a large market such as New York State, where annual premiums exceed $1 billion, potential savings to consumers are in the tens of millions of dollars. That is one reason why a Temporary Commission on Banking, Insurance and Financial Services in New York State has recommended that the State's laws be changed to allow banks to sell insurance.

The bottom line is that consumers across the country are missing an opportunity to save millions of dollars because of the remaining constraints on bank holding company sales of insurance. The deregulatory progress made by Title VI should be continued so that all bank holding companies, regardless of size, are able to sell insurance of all kinds.

Mr. Chairman, this concludes my oral statement. In succeeding pages, I outline the issues in more detail, and I should be happy to answer any questions you may have on the subject.

* * * *

Section 2--The "Real" South Dakota Loophole

To appreciate the controversy surrounding the so-called "South Dakota loophole" requires an understanding of the regulatory framework relating to bank holding companies and knowledge of events surrounding the application by Citicorp, New York, to acquire a South Dakota bank for the purpose of conducting insurance activities.

Bank holding companies may engage in nonbanking activities, including insurance agency and brokerage, primarily in two ways. First, they may conduct the activity in a separate subsidiary of the bank holding company pursuant to section 4(c)(8) of the Bank Holding Company Act, which is administered by the Federal Reserve Board. Such subsidiaries are limited to activities that are "closely related" to banking; in the case of insurance activities, such nonbank subsidiaries generally are prohibited from engaging in agency and underwriting activities except as permitted in seven specific exceptions enumerated in Title VI of the Garn - St Germain Depository Institutions Act of 1982.

Second, bank holding companies may conduct nonbanking activities, including insurance activities, directly or indirectly through their bank subsidiaries. The type of activities allowable under this authority historically has been left to the discretion of the bank's chartering authority.[1] The scope of nonbanking activities, including insurance underwriting and agency activities, that has been permitted for state banks by their respective chartering authorities, varies substantially. For example, some states have allowed their banks to exercise broader, and some states have permitted narrower, activities than authorized for nonbanking subsidiaries by the Federal Reserve Board under the Bank Holding Company Act.[2] Until 1983, however, the conduct of such activities by state banks had been in fact limited geographically primarily to the chartering state.

In March 1983, the state of South Dakota enacted legislation that: (1) permitted its state banks directly and indirectly to engage in "every facet" of the insurance business; (2) discouraged those activities from being conducted in South Dakota; (3) encouraged them to be conducted outside of South Dakota and; (4) permitted out-of-state bank holding companies to acquire banks engaged in such insurance activities.[3] Pursuant to this state statutory authority, Citicorp, New York, applied to the Federal Reserve Board under section 3 of the Bank Holding Company Act to acquire American State Bank of Rapid City, Rapid City, South Dakota. American State Bank is a relatively small bank ($175 million in assets), employs only 28 individuals, and is limited by South Dakota law to operating a single banking office in South Dakota. In addition to the banking activities that would be conducted pursuant to the statutory limitations, Citicorp intended to use American State Bank to conduct the underwriting of life insurance and accident and health insurance and annunities and to act as agent or broker for the sale of all lines of insurance on a nationwide basis. These insurance activities are broader than are permitted for nonbanking subsidiaries of bank holding companies and were intended by Citicorp to constitute the prepondence of all activities to be conducted through American State Bank by Citicorp.

By order dated August 1, 1985, the Federal Reserve Board denied the application by Citicorp to acquire American State Bank. The Board found that Citicorp's proposal to engage in insurance activities to the "fullest extent possible" under the South Dakota Statute (which precludes the conduct of such activity within South Dakota) constituted an evasion of the nonbanking provisions of the Bank Holding Company Act. Accordingly, the Board utilized its authority under section 5(b) of the Bank Holding Company Act to deny this proposal, and, therefore, close the South Dakota "loophole."

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[1] The Federal Reserve Board recently has indicated that it may attempt to revise its current policy of noninterference with the activities of state bank subsidiaries of bank holding companies.

[2] For example, the states of Wisconsin, Indiana, Iowa, Minnesota, Missouri, New Jersey, and North Dakota currently permit their banks to engage in insurance activities broader than permitted for bank holding companies under the Bank Holding Company Act.

[3] South Dakota Codified Laws Ann. §51-18-30 (1984).

We believe the Federal Reserve Board's action of August 1 with regard to the Citicorp application essentially moots the need for legislation to address the South Dakota issue. Moreover, we believe that several of the legislative proposals currently pending in Congress represent an overreaction to practices that in fact do not exist or pose substantial problems. Finally, many of these proposals unnecessarily limit the ability of state authorities to regulate their chartered institutions.

In this last regard, we note that the concept of the dual banking system provides that the states be permitted to authorize their banking institutions to innovate within their borders with new products and services, even if such services are broader than those permitted under the Federal Bank Holding Company Act. This is a principle that pre-dates the Bank Holding Company Act and was not intended to be addressed by the provisions of that Act. In fact, most states have followed this practice without controversy for many years and the country generally has benefited. For example, checking accounts, thrift services, residential mortgage lending, trust powers, and many of the activities currently permissible under the Bank Holding Act grew out of this fertile ground.

Unfortunately, bills recently introduced disregard this history and suggest statutory provisions that impose wide reaching limitations on state authorities. For example, H.R. 1923 and H.R. 428 would prohibit the exportation of not only insurance, but of all state authorized products broader than those permitted under federal bank holding company law. Other proposals, such as H.R. 1513, also would restrict the powers of independent state banks not within holding company systems. Most significantly, bills such as S. 716, essentially would "federalize" the nonbanking powers that state-chartered banks may exercise—even within their home state's jurisdiction.

The approach suggested by several of these bills is predicated upon Senator Dodd's amendment to last year's Financial Services Competitive Equity Act (S. 2851). The Dodd Amendment would have applied the restrictions of federal law to the in-state insurance activities of state-chartered banks. Fortunately, that provision was not finally enacted. The effect of the Dodd amendment and similar proposals would be to rescind the right of the states to grant full charters to their institutions.

A need for these overreaching legislative proposals is not apparent from the record. No factual evidence of abuse exists. Moreover, as described above, the Federal Reserve Board has asserted its jurisdiction to prevent evasions of federal law. Theoretically, it may be urged that restrictions are necessary to protect the safety and soundness of the banking system or that banking organizations should not be allowed to engage in risky businesses under the auspices of FDIC insurance. We do not disagree. However, the legislative proposals submitted so far do not make distinctions upon the basis of risk inherent in various nonbanking activities. As demonstrated by the prior testimony of Chairman Volcker, many of the insurance activities (especially agency and brokerage functions) that would be prohibited by H.R. 1513 and other legislative proposals do not contain substantial risks.

In summary, we believe the "real" South Dakota loophole has been addressed by the August 1 decision of the Federal Reserve Board. Action by the Congress is not needed.

Section 3—Consumer Interests

The last time this subcommittee directly addressed the issue of insurance activities of bank holding companies was in June 1979. It is apparent from even a casual review of the record of those hearings that the arguments over bank insurance sales and underwriting have not advanced much beyond those made at that time. The 1979 record is replete with charges made by the insurance industry--much the same as today's—and of our responses. The voice of the consumer was heard only dimly, if at all.

Meanwhile, however, the interest of certain consumer representatives has been piqued by the notion that average Americans can save money if insurance were sold through bank holding companies. For example, one such spokesman, J. Robert Hunter, president of the National Insurance Consumer Organization (NICO), told the Senate Banking Committee on March 13, 1984, that banks should be allowed to enter the insurance business. He said that concerns about potentially abusive practices can be alleviated, and should not be allowed to stand as impediments to the injection of new competition.

The thrust of Mr. Hunter's comments was that bank holding companies should become not only agents and brokers of insurance but also underwriters. If bank holding companies were to become "direct writers" of insurance, he said, this would be "a potential boon to competition." He went on:

> . . .Insurance companies today own banks. Securities dealers own banks and insurance companies. Insurance companies own securities dealers. Why should the banks be prohibited from doing what other entities are doing? There is no justification for that.

Later, in an exchange with Chairman Garn, Mr. Hunter was asked if "directly written insurance is less expensive than insurance sold through agents?" Mr. Hunter reported that it tends to be about 8 to 10 percent less costly to consumers. Then Chairman Garn asked what may happen to the counseling or advice that individual insurance agents today provide their clients. Mr. Hunter's reply:

> . . .some people want a lot of counseling and advice and that's fine, just as some people want to shop at Bloomingdale's. . . . There will always be a role for counseling (but) some people will just want price and less counseling. . .

Mr. Chairman, I believe Mr. Hunter's remarks sum up the situation in a nutshell. As I indicated in section 1, the potential savings to consumers by using the bank holding company vehicle run into the tens of millions of dollars. Not everyone will choose to take advantage of the price and product value that our members could offer, but some will. Why should they be denied this choice?

Our friends at Sears, Roebuck and Co. understand this all too well. Their marketing initiative of placing financial service kiosks in their retail stores includes insurance as a core product along with deposit and brokerage services. This will soon be much expanded when the "Discover" card gets off the ground. We have no complaint with the Sears initiative. It brings moderately-priced insurance products within the reach of more Americans.

Incidentally, I believe bank holding companies can go Mr. Hunter one better. Buying insurance products from bank holding companies at a lower price need not preclude consumers' obtaining accurate and timely advice and information. Many bank holding companies are equipped today to offer consumer counseling services. Many more of our members could do so once additional products and services were in place. Thus, bank holding companies can be formidable competitors in the insurance marketplace because they can offer a combination of counseling and competitively-priced products.

A somewhat more conservative view of how far bank holding companies should be allowed to go into the insurance business was offered to the Senate Banking Committee last year (March 27, 1984) by Chairman Volcker of the Federal Reserve Board. His list of insurance activities Congress should authorize included unlimited insurance brokerage activities and home mortgage protection insurance underwriting. (Chairman Volcker on August 22, 1985, released a concurring statement accompanying a Board decision in which he saw certain property and casualty insurance underwriting activities proposed by Citicorp in Australia to have "manageable" risks, provided they be conducted through a subsidiary of the holding company and not of a bank.)

Present congressional policy as expressed in Title VI is ambivalent; it should be reconciled with the needs of consumers, as expressed by NICO, and with the concerns of the regulators, as expressed by Chairman Volcker.

Section 4—Public Policy Concerns

The opponents of bank holding company expansion into additional lines of products and services cite a number of public policy concerns which they view as so critical as to permanently bar such expansion.

One objection is that bank holding companies should not take on any activity that poses the threat of excessive risk to the banking system. Chairman Volcker, in his concurring statement of August 22, dealt with the question of risk in the context of insurance underwriting. On other occasions, he has asserted that neither insurance nor real estate brokerage present major issues of risk to bank holding companies.

In the May 1984 issue of the Economic Review, published by the Federal Reserve Bank of Atlanta, Larry D. Wall and Robert A. Eisenbeis developed a quantitiative measure of risk for financial services activities. In placing numerical values on risk, they found that the least risky of all financial services activities were insurance and real estate brokerage. Interestingly, one of the riskier businesses was operating a savings and loan association--S&L's, of course, are allowed a full range of brokerage activities, both insurance and real estate, and in some cases are affiliated with insurance companies.

Consequently, opposition to bank holding company sales of insurance, and, to some extent, underwriting, cannot be based on the fear of excessive risk. On the contrary, income generated by these activities will enhance the financial strength of the bank holding company, its bank subsidiaries, and the banking system as a whole. Bank holding company insurance sales thus will tend to increase the overall safety and soundness of the banking system, a fact Congress should keep in mind as it examines the issues of deposit insurance and bank deregulation.

A second assertion, particularly favored by our opponents in the insurance industry, is that bank holding companies will engage in the illegal practice of "tying" insurance products and services with the extension of credit to consumers. There are two fundamental problems with this argument. First, if the argument is valid, then Congress has failed to deal with the issue. Title VI, as I mentioned, virtually deregulated all bank holding companies having assets of under $50 million. If "tying" is a problem, then there is no public policy reason to exclude these thousands of companies from the prohibitions in the law, particularly when many of these companies exercise substantial market power in smaller towns and cities. This is where the threat of "tying" can be most severe. Furthermore, Congress has done nothing to prohibit other lenders--S&L's, mutual savings banks, insurance companies, securities firms, and retailers--from selling insurance products and services.

As an example, Metropolitan Life Insurance Co. of New York announced on August 20 that it will acquire Century 21 Real Estate Corporation, the largest real estate brokerage firm in the country. The purpose—to "tie" its insurance products with the sale and financing of homes. An announcement by Metropolitan said: "Century 21 will serve as one cornerstone of a full range of financial relationships between home buyers and Metropolitan." This plan goes far beyond anything bank holding companies may now do. An officer of Metropolitan confirmed the company's thinking: "There's a great potential at the point of sale for home owner's insurance and mortgage redemption insurance." (All information from American Banker, August 21, 1985).

Mr. Chairman, clearly marketplace realities contradict the "tying" argument. If Congress believes the insurance industry's continuing allegations, even while the industry's most prominent members position themselves to engage in "tying," then it has a formidable task in making the prohibitions in Title VI applicable to all financial industry participants.

Over a year ago, the firm of Chase, Brown and Blaxall, at our request, prepared a definitive study on the "tying" question, since it seems to have a life of its own apart from marketplace realities. (The study's principal author was John Prather Brown, a former economist with the Federal Trade Commission.) The Chase, Brown and Blaxall study noted that "bundling" of products is as old as department stores and automobiles (we could buy our automobile's engine separately, for example, in a transaction distinct from the purchase of the body and frame.) The reasons that such "bundling" exists are obvious: convenience—and lower prices.

Improper "tying" can occur, Chase Brown and Blaxall argue, only when two conditions are present in a market. First, when a seller has sufficient market dominance to require the purchase of another product (this is the classical anti-trust problem); second, when buyers are unable to make informed choices due to misinformation or lack of information. The first problem--market dominance--does not exist in the market for consumer credit. Far too many competitors are in it for any one lender to exert dominance. And, "tying" is illegal for banks and bank holding companies.

The second problem--providing consumers with adequate information, can be easily dealt with by amendment and enforcement of the Truth in Lending Act. The Act could be amended to require lenders to furnish appropriate disclosures; there could also be a mandatory "cooling off" period of 15 to 30 days, during which time a buyer would have the right to rescind his insurance purchase and obtain any necessary coverage from another source. Also, the good work of organizations such as Consumers Union and local consumer groups should not be overlooked. These organizations have the capacity to inform consumers about their rights.

In short, there is no reason why any public policy concerns regarding risk or "tying" should serve as a bar to the further entry of bank holding companies into the insurance business.

Section 5—The Future of Banking and Insurance

Changes seem to be sweeping through the insurance industry at least as rapidly as they are through banking. An occasional voice is heard from that industry indicating that the traditional ways of producing and selling insurance products and services are no longer viable.

Some companies are voting with their funds--Prudential has merged with Bache, and owns a bank; Metropolitan Life is moving into all sectors of the consumer financial services business; other companies are insisting that the laws separating banking and insurance be changed. As one example, E. James Morton, President and Chief Operating Officer of John Hancock Mutual Life Insurance Company, said in a recent speech (May 6, 1985) that insurance companies must be able to offer banking services in order to compete, and that, contrariwise, banks should be able to own insurance companies:

> . . .I don't think the life insurance industry is serving its own interests by trying to stop the obvious and natural evolution of the marketplace. . .the future of most life insurers probably lies either in filling specialty niches or in diversifying. . . .

Another indicator of change is the recent experiments where insurance agents sign leases of bank space in order to sell their products. In spite of outraged cries from the entrenched insurance interests, these experiments are going ahead. The obvious aim is to find a way for both parties--the banks and the agents--to profit, while also serving consumers. It is unfortunate that such efforts are so hemmed in by archaic laws and regulation, both at the federal and state level, that implementation of these innovative sales efforts is often difficult to carry out efficiently. Still, the experiments proceed.

Unless Congress can successfully roll back the blending of the two industries that has occurred over the past decade, then it may have no alternative but to consider whether to enact a broad holding company act, one that encompasses all participants in the financial services market, not just bank holding companies. This broader law could be concerned with benefits to the public; fair competition; and the integrity of depository institutions. Thus, building on the framework established by the Bank Holding Company Act, Congress could provide the American public with an updated institutional and regulatory framework in which the vital financial services could be delivered both efficiently and safely.

The alternative is continuation of the rigid legislative and regulatory provisions now applicable primarily to bank holding companies, a situation that does not bode well for our industry's future—or for consumers.

Chairman St Germain. Thank you, Mr. Roberts.

At this point, the subcommittee will be in recess for about 10 minutes so we can attend to duties on the floor. I caution the people in the audience—don't go mill around too much as you may lose your seat and won't be able to get back in for the stellar performances to follow.

We want to be able to get right back to business when we return. We have a lot of witnesses to hear from. Let's hold for a minute here.

[Recess.]

Chairman St Germain. The subcommittee will come to order.

We will now hear from James L. Ryan, representing the American Bankers Association.

Mr. Ryan?

STATEMENT OF JAMES L. RYAN, MEMBER, GOVERNMENT RELATIONS COUNCIL, AMERICAN BANKERS ASSOCIATION [ABA]

Mr. Ryan. Mr. Chairman and members of the subcommittee, my name is James L. Ryan and I am president and chief executive officer of the Bank of Walnut Creek, CA, and a member of the Government Relations Council of the American Bankers Association. I am pleased to be here today to present the views of the association on the authority of States to authorize new products and services for the banks they charter and supervise.

The dual banking system is based on the view that our Nation's State and federally-chartered banks can adapt most readily to changing market conditions under a regulatory structure that provides flexibility in asset and liability management.

At the same time, the existence of overall Federal oversight through the Federal Deposit Insurance Corporation on the safety and soundness practices of all insured banks assures that, whatever their charter, all commercial banks will maintain a level of safety and soundness in their operations that will minimize risks in the Federal deposit insurance fund.

Under this overall umbrella, the dual banking system operates to prevent any single monolithic bank regulatory agency from so strangling the banking system as to make it incapable of responding quickly and efficiently to changes in the marketplace.

It must be remembered that the dual banking system has worked well both in providing banks with the authority they needed to compete in a changing environment and in developing and demonstrating new supervisory and enforcement techniques that effectively enhance the safety and soundness of banks subject to them.

The dual banking system is a two-way street. Not only does it provide the opportunity for banks to seek additional authorities from one supervisory agency when another is unresponsive; but it also allows one set of supervisors to develop restrictions on banking activities in a fashion that tests the efficacy of the restrictions before they are applied to the entire banking population of the Nation.

Evidence of the dynamics of the interaction of State and Federal law through the dual banking system is easy to find. Most recently, the initiatives for the development of nationwide NOW accounts authorized by this committee in 1980 were first taken by State-chartered depository institutions in Massachusetts almost 10 years previously.

At the same time, long before this committee adopted the restrictions on bank holding company insurance sales that later became title VI of the Garn-St Germain Depository Institutions Act of 1982, a majority of States had restricted or defined the ability of their State-chartered banks to get into the insurance business.

Thus, it is important to remember that the dual banking system may operate both as a limitation on bank activities as well as an authorization of new banking powers.

Today, the States are moving toward the authorization of additional products and services for the banks that they charter and supervise. Many of the States which had previously restricted the banking industry's ability to sell insurance, such as South Dakota, are today providing positive authorization for bank insurance agency activities, either through legislation or through the action of the State banking commissioners.

In reviewing the so-called South Dakota loophole, therefore, it is important that this committee keep in mind the dynamic and ever-changing nature of the relationship between Federal and State banking regulation that constitutes the dual banking system.

The immediate focus of this committee is on this so-called South Dakota loophole. In brief, the State of South Dakota presently authorizes out-of-State bank holding companies to purchase South Dakota banks for the purpose of engaging in, among other things, insurance underwriting and sales.

To the limited extent that this hearing is focusing on that particular South Dakota law, there is no need for the committee to consider this issue further. The Federal Reserve Board, in a recent decision, has effectively closed this South Dakota loophole.

At the same time, however, this subcommittee is also reviewing the ability of States to enhance the competitive ability of the banks that they charter and regulate in ways that the Federal Congress has not yet provided for national banks or bank holding companies.

Some have suggested that the States should be subject to Federal restrictions on their ability to authorize new banking powers.

Our association would strongly oppose any such restrictions. As we have demonstrated above, the vitality and competitive health of the banking industry in this country depends on the continued existence of the dual banking system; and it is the essence of that system that State legislators as well as the Federal Government be able to regulate the activities of the banks that they charter.

There is an additional issue that is raised by this hearing. And that is the ability of banks to sell insurance. Our association believes that it would be inequitable, illogical, and hypocritical for the insurance industry to come before this subcommittee and advocate additional restrictions on banking's ability to engage in insurance sales and underwriting.

As we stated above, no objection was heard from the insurance industry when a large number of States many years ago began to restrict the ability of the banks that they charter and supervise to sell insurance.

This same industry, which now finds its arguments at the State level yielding to the pressure of consumers of banking services, is now coming before this committee in an attempt to achieve at the Federal level what they could not achieve at the State level.

At the same time, however, the McCarran-Ferguson Act precludes the application of such Federal laws and regulations as the antitrust laws to the insurance industry. Thus, the very agents who charged the banking industry, which is by virtue of section 106 of the Bank Holding Company Act, as well as the general antitrust laws, subject to stringent antitie-in provisions, with seeking to promote tie-in sales through the linking of lending and insurance, are not subject to any similar restrictions under the antitrust laws.

The insurance industry which hides behind McCarran-Ferguson whenever the possibility of Federal regulation of their activity looms, is at the same time attempting to use Federal law as a club to stop banking's involvement in insurance sales. They can't have it both ways.

Our association believes that consumers will be very well-served by banks being allowed to engage in insurance sales. The record of banking's activity in new products and services in recent years is replete with examples of banks expanding the market for these products and services to the benefit of all competitors as well as providing additional convenience and services to consumers.

We, therefore, would strongly advocate this committee's consideration of the competitive ability of all types of banks, rather than considering narrow special interest legislation designed to restrict States' rights to determine the destiny of their own depository institutions.

Mr. Chairman, I appreciate the opportunity that you have provided to our association to testify here today. I am now prepared to answer any questions that you may have.

[The prepared statement with attachments of Mr. Ryan on behalf of the American Bankers Association [ABA] follows:]

STATEMENT

OF

JAMES L. RYAN

on behalf of

THE AMERICAN BANKERS ASSOCIATION

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE

of the

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

SEPTEMBER 11, 1985

Mr. Chairman and members of the Subcommittee: I am James L. Ryan, President and Chief Executive Officer of the Bank of Walnut Creek, California, and a member of the Government Relations Council of the American Bankers Association. The combined assets of our members comprise approximately 95 percent of the industry total. Our members range in size from the smallest to the largest banks, and close to 85 percent of them have assets of less than $100 million. I welcome the opportunity to present ABA's views on the authority of states to authorize new products or services for the banks they charter and supervise. This authority is inherent in the system of co-equal bank chartering, supervision, and regulation called the "dual banking system."

The dual banking system is based on the view that our nation's state and Federally chartered banks can adapt most readily to changing market conditions under a regulatory structure that provides flexibility in asset and liability management. At the same time, the existence of overall Federal oversight through the Federal Deposit Insurance Corporation on the safety and soundness practices of all insured banks assures that, whatever their charter, all commercial banks will maintain a level of safety and soundness in their operations that will minimize risks to the Federal deposit insurance fund. Under this overall umbrella, the dual banking system operates to prevent any single monolithic bank regulatory agency from so strangling the banking system as to make it incapable of responding quickly and efficiently to changes in the marketplace.

It must be remembered that the dual banking system has worked well both in providing banks with the authority they needed to compete in a changing environment and in developing and demonstrating new supervisory and enforcement techniques that effectively enhance the safety and soundness of banks subject to them. The dual banking system is a two-way street. Not only does it provide the opportunity for banks to seek additional authorities from one supervisory agency when another is nonresponsive, but it also allows one set of supervisors to develop restrictions on banking activities in a fashion that tests the efficacy of the restrictions before they are applied to the entire banking population of the nation.

Evidence of the dynamics of the interaction of state and Federal law through the dual banking system is easy to find. Most recently, the initiatives for the development of nationwide NOW accounts authorized by this Committee in 1980 were first taken by state-chartered depository institutions in Massachusetts almost 10 years previously. At the same time, long before this Committee adopted the restrictions on bank holding company insurance sales that later became Title VI of the Garn-St Germain Depository Institutions Act of 1982, a majority of states had restricted or defined the ability of their state-chartered banks to get into the insurance business. Thus, it is important to remember that the dual banking system may operate both as a limitation on bank activities as well as an authorization for new banking powers.

Today, the states are moving toward the authorization of additional products and services for the banks that they charter and supervise. Many of the states which had previously restricted the banking industry's ability to sell insurance (such as South Dakota) are today providing positive authorization for bank insurance agency activities, either through legislation or through the action of the state banking commissioners. In reviewing the so-called South Dakota loophole, therefore, it is important that this Committee keep in mind the dynamic and ever-changing nature of the relationship between Federal and state banking regulation that constitutes the dual banking system.

The immediate focus of these hearings is on the specific statute in South Dakota that authorizes out-of-state bank holding companies to acquire in-state banks and offer a full range of insurance activities, including underwriting, through that mechanism. Our Association believes that the recent Federal Reserve Board decision limiting the ability of out-of-state bank holding companies to take advantage of the acquisition of South Dakota banks for the sole purpose of engaging in insurance activities eliminates this so-called South Dakota loophole, and obviates the need for any legislation restricting states' abilities to authorize new banking authorities. Moreover, our Association would strongly oppose any attack on the dual banking system that would restrict states in their decisionmaking as to whether to grant or restrict the banking powers of state-chartered and supervised banks.

The "South Dakota" Issue

While the emergence of individual and corporate innovators has been an inherent part of the process by which "market forces" effected and continue to effect change in the financial services business, the existence of innovators is not limited to the business sector. For example, such states as Delaware and South Dakota might be regarded as "innovators" by pursuing economic development through legislation permitting out-of-state holding companies to establish limited-service banking organizations within their jurisdiction.

In 1983, South Dakota enacted a law that permits out-of-state bank holding companies to acquire a single _de novo_ or existing state-chartered bank and a single _de novo_ national bank. The law also authorizes all state-chartered banks to engage in all facets of the insurance business either directly or through subsidiaries.

The purpose of the law, according to its preamble, is to "cause new employment within the state by attracting new business;... help alleviate the economic conditions which currently adversely impact the people and the government;... create additional and necessary tax revenues for the support of the state government and its existing institutions; and... help ensure the continued operation of the state government and its existing institutions upon sound and balanced financial principles."

On August 1 of this year, the Federal Reserve Board issued its first decision interpreting this law.

The Board's decision denied the application of a bank holding company to buy a South Dakota-chartered bank.

In this decision, the Federal Reserve was asked to consider whether an out-of-state bank holding company could acquire a South Dakota bank for the purpose of engaging in insurance underwriting and selling. The Board denied the application. In doing so, however, it is important to note that the Board did not challenge the right of state legislators to provide to state-chartered banks the authority to engage in a nontraditional banking activity. The Board's decision was primarily aimed at, what the Board perceived to be, an evasion of the restrictions of the Bank Holding Company Act itself.

Two of the most important sections of the Bank Holding Company Act are Sections 3 and 4. Section 3 defines the circumstances under which the Board can approve an application by a bank holding company to acquire a bank. Section 4 is concerned with the appropriate extent of nonbanking activities in which bank holding companies can engage. The result of the Board's decision is that banks can not be established by bank holding companies as shells, with few traditional banking functions, for the purpose of engaging in only nontraditional banking activities that exceed the powers of bank holding companies.

The Board held that the application under consideration, even though it fell under Section 3 of the Bank Holding Company Act and was an application by a holding company to acquire a bank, was in fact a disguised application to acquire a nonbanking activity (insurance underwriting and sales) presently forbidden under Section 4 of the Act to bank holding companies. The Board thus used its powers to prevent evasions of the Bank Holding Company Act to close the so-called South Dakota loophole by ensuring that banks will not become mere shells for engaging in nonbanking activities.

Our Association would therefore suggest that the Board's decision obviates any need for legislation to address the so-called South Dakota loophole.

At the same time, however, this Subcommittee is also reviewing the ability of states to enhance the competitive ability of the banks that they charter and regulate in ways that the Federal Congress has not yet provided for national banks or bank holding companies. Some have suggested that the states should be subject to federal restrictions on their ability to authorize new banking powers. Our Association would strongly oppose any such restrictions. The vitality and competitive health of the banking industry in this country depends on the continued existence of the dual banking system; and it is the essence of that system that state legislators as well as the Federal government be able to regulate the activities of the banks that they charter.

Our Association has come before this Subcommittee many times on many issues to argue for preservation of the dual banking system. We have often emphasized that the dual banking system provides checks and balances to the concentration and abuse of regulatory power. We have also emphasized that the dual banking system is a framework of regulation that accommodates innovation and change in banking's response to the public convenience and need. Its continued existence is of crucial importance to the preservation of a sound banking system.

Consequently, we strongly support the right of a state to permit insurance or other new activities for its state-chartered banks and bank holding companies. We would strongly oppose legislation that would nullify state laws and regulations authorizing nontraditional activities for state-chartered institutions.

There is an additional issue that is raised by this hearing. And that is the ability of banks to sell insurance. Our Association believes that it would be inequitable, illogical, and hypocritical for the insurance industry to come before this Subcommittee and advocate additional restrictions on banking's ability to engage in insurance sales and underwriting. As we stated above, no objection was heard from the insurance industry when a large number of states many years ago began to restrict the ability of the banks that they charter and supervise to sell insurance. This same industry, which now finds its arguments at the state level yielding to the pressure of consumers of banking services, is now coming before this Committee in an attempt to achieve at the Federal level what they could not achieve at the state level.

Using state bank insurance authorities as an example, we found in a 1984 survey of state bankers associations that legislation to limit state-granted banking authority would inhibit bank insurance activities that are now permitted by the states of Alabama, Indiana, Iowa, Maryland, Minnesota, Mississippi, Missouri, Montana, Nebraska, North Carolina, Oregon, South Dakota, Wisconsin and Wyoming.

Also inhibited would be the insurance activities in states that have no specific law on the subject. These included the states of Alaska (administrative regulations), Arizona, North Dakota, Oklahoma, South Carolina and West Virginia. Also affected would be New York, which is considering the authorization of insurance activities for its state-chartered institutions.

Because of that possibility, a June 27, 1985 New York Times editorial, "Let Banks Sell Insurance," (see Attachment 1) concluded:

> Banks think they can sell insurance more cheaply and conveniently than insurance companies. Insurers apparently think so too, for they are fighting an effort by banks in New York State to enter the business. In fact they are going further, asking Congress for a national prohibition against the underwriting or brokerage of insurance by banks.

> It's hard to know if the banks' claims are right, or how much of a threat they pose to established insurance companies and agents. But consumers have something to gain and little to lose from the increased competition. That's reason enough for New York's Legislature to say yes — and for Congress to stay out of the fight.

Changes and improvements will come, and they will come either within the dual banking system or at the expense of it. Where state laws are out-of-date and are impeding the financial and economic development of the area, they will be reviewed and improved. This applies not only to statutes affecting bank and bank holding company lending, investing, and other powers, but to structural matters as well. This approach to progress in the banking industry -- through actions that will strengthen, not weaken, the dual system, and which are consistent with the principle of states' rights — has the longstanding support and cooperation of our Association.

The ABA believes that Congress should preserve the ability of any state to authorize insurance or other new activities for its state-chartered institutions.

Banking's Insurance Activities

Financial innovation has been and continues to be stimulated by the rising affluence of the U.S. economy. This rising affluence has resulted in new demands for financial services. These new demands have been not only for greater volumes of financial assets and services, but for a more varied selection of such assets and services from traditional providers.

Regulation has been a pervasive factor affecting the areas of development of the financial services industry. Unfortunately, in some areas, regulation has restrained and thwarted change. At the same time, a great deal of innovation has been directed to the circumvention of regulations perceived as interfering with appropriate responses to "market forces." As regulation has imposed different sets of rules on different types of institutions in the financial services business, the direction of change has been much influenced by inequities in regulation.

Insurance companies compete with commercial banks and other depository institutions both on the deposit side, through the savings aspect of insurance products, and on the asset side, through their investment portfolios. But they are also active~~ly involved~~ in noninsurance areas including mutual funds, brokerage, cash management, mortgage banking, leasing, and consumer finance. [1] Furthermore, numerous insurance companies and other diversified financial firms with insurance operations own nonbank banks (see Attachment 2).

As we testified in April during this Subcommittee's hearings on proposed nonbank bank legislation, even if the nonbank-bank loophole is closed, diversified financial firms would still be able to offer deposit services to their customers by providing a deposit substitute such as a money market fund or a cash management type account from which third-party transfers can be made, and by selling the deposits of banks or thrifts to their customers as a deposit broker. Moreover, many nonbanking companies are grandfathered and can acquire unitary savings and loans. In addition, they would still be able to offer consumer, real estate, and commercial loans in the same manner as banks while they are continuing their primary activities, which in some cases include all of the securities, real estate, and insurance powers outlined in our consensus position. The fact that consumer-type money market funds still have assets of approximately $175 billion despite the tremendous success of the money market deposit account highlights the importance of being able to meet current and future customer needs by offering a full range of financial services.

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[1] Christine Pavel and Harvey Rosenblum, "Banks and nonbanks: The horse race continues," Economic Perspectives, Federal Reserve Bank of Chicago, May/June 1985, pp 3 - 17.

Our Association believes that the appropriate response to this continuing competitive imbalance would be for Congress to give all financial institutions the authority to offer the full range of financial services that their customers demand. The way to properly diversify the asset portfolio of the banking industry is to allow bank holding companies to enter the fields of securities, real estate and insurance.

By offering new financial products and services, the banking industry could save consumers billions of dollars. In the process, the industry also would generate earnings from fee income -- earnings that are required to keep the American financial system safe and sound.

The banking industry has been in the insurance business for years. Under federal law, for example, national banks are permitted to offer insurance services in towns with 5,000 or fewer residents. Additionally, as I indicated earlier, state-chartered banks have the authority to provide more extensive insurance services than national banks in several states. In some areas (e.g., the midwest), the combination of banking and insurance has been commonplace for decades. In fact, a sizeable portion of the members of the Independent Agents of America's affiliated state organizations in the midwest are bank agents.

Under current provisions of the Bank Holding Company Act as amended by Title VI of the Garn-St Germain Act of 1982, a bank holding company and its nonbank subsidiaries are generally precluded from engaging in insurance activities. However, this general prohibition is subject to several specific exceptions set forth below.

Exception (1) permits bank holding companies and their subsidiaries to offer credit life, health, accident and unemployment insurance to their customers.

Exception (2) permits property insurance on collateral offered by a consumer finance subsidiary where the extension of credit is $10,000 or less or, in the case of a residential manufactured home, the extension of credit is $25,000 or less.

Exception (3) permits any insurance agency activity in a place that has a population of 5,000 persons or less. Exception (3) also permits a bank holding company to demonstrate that a location has inadequate insurance agency facilities.

Exception (4) is the grandfather clause. It grandfathers any insurance "activities" engaged in by the bank holding company or its subsidiaries on May 1, 1982 or approved by the Board on the date or for which permission had been applied for on that date, including any subsidiaries with whom the holding company had a binding acquisition on that date.

Exception (5) permits smaller bank holding companies (those of $50 million in total assets or less) to engage in any insurance activity except they are prohibited from selling life insurance and annuities unless they are within the scope of (1) (credit life) or (3) (small town authorization) discussed above.

Exception (6) grandfathers any activities of registered bank holding companies which were engaged in on January 1, 1971 and which had been approved by the Federal Reserve Board.

Also, the banking industry can enter the insurance business in other ways, including bank and bank holding company service corporation activities, "passive" insurance investments, and foreign operations.

The Insurance Brokerage/Agency Business

We believe that the financial nature of insurance activities makes the brokerage/agency business and underwriting compatible with banking. The brokerage/agency business would be more attractive to smaller institutions. Risks associated with insurance brokerage/agency operations are low. Additionally, barriers to entry into this business are low, as is the capital requirement associated with operating a brokerage firm or insurance agency. Banks are well positioned to enter the business because most lines of insurance are needed by bank customers and are compatible with credit offerings made by banks.

A 1983 study prepared for the ABA by Arthur Young & Company notes that banks' retail branch networks are admirably situated to offer insurance more efficiently and on lower margins than many independent insurance agents. The Arthur Young study also concludes that a threat to the brokerage/agency business comes from the underwriters who have begun to find alternative methods of marketing their insurance products. These alternative methods include direct mail, mass marketing, and marketing through closely related financial institutions and financial planning clinics. This trend is highlighted in a 1984 paper commissioned by the Office of the Comptroller of the Currency, which describes the range of possible independent agent/bank affiliations that could benefit both parties in the current competitive and regulatory environment. [1]

Early this year, the Research Division of the ABA worked with an independent consultant to develop reliable estimates of the benefits that consumers would receive from deregulation of various products and services. For life insurance, they estimated that bankers could save the average consumer about $72 a year. Because the market for life insurance is so large, the aggregate savings for all consumers in the United States could be about $940 million each year.

This estimate was derived from the experience of savings banks in Massachusetts which have been specifically permitted to sell life insurance to their customers for more than 75 years, although significant protectionist restrictions severely limit their ability to compete. Savings banks in New York and Connecticut are also permitted to sell life insurance, but Massachusetts was chosen because its regulation of these sales is the least restrictive.

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[1] David Hales/Hales & Associates, "The Insurance Distribution System and Banks," (Prepared for the Office of the Comptroller of the Currency, March 22, 1984), pp. 6 - 21.

A June 16, 1985 New York Times editorial, "Protect this Insurance Triumph," emphasized the difficulty New York savings banks have had in getting an increase in the coverage limit despite the obvious consumer benefits (see Attachment 3).

> Some 700,000 New Yorkers buy life insurance from the Savings Bank Life Insurance Fund, and no wonder. It's cheap, uncomplicated and sold without high-pressure tactics. But S.B.L.I. has one serious drawback: By state law, coverage is limited to $30,000. Raising that ceiling is long overdue.
>
> ...A vote is scheduled in the Assembly next week on a bill to raise the coverage limit to $100,000. That's the very least the Legislature can do to defend S.B.L.I., a triumph for consumers, from an insurance lobby eager to bury it.

Subsequently, the coverage limit was raised to $50,000.

In his book, The Invisible Bankers, Andrew Tobias quotes a senior executive at Equitable Life Assurance Society that, "anyone who did not first purchase all the Saving Bank Life Insurance he or she qualified for, before buying additional coverage elsewhere, was throwing money down the drain." [1]

Homeowners and automobile insurance are among the types of coverage consumers would be most likely to buy through financial institutions, according to a recent national survey by the Unidex Corporation.

The 1984 survey asked nearly 1,800 persons 18 years and older about their insurance needs and whether they would buy these services from financial institutions. Younger customers, those with incomes of less than $30,000 and comparatively low savings balances, were most receptive to the idea of buying insurance through a financial institution, Unidex said.

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[1] Andrew Tobias, The Invisible Bankers - Everything the Insurance Industry Never Wanted You to Know, (New York: The Linden Press/Simon & Schuster, 1982), p. 240.

In addition, the National Insurance Consumer Organization (NICO) recently testified that major lines of insurance and many state markets are highly concentrated. NICO concluded that concentration may be reduced and jobs saved (although changed) by allowing banks and others to offer insurance.

Finally, it should be noted that the president of at least one large life insurance company believes that, "the time has come for the life insurance industry to wake up and accept the reality of today's financial services marketplace." The views of E. James Morton, president and chief operations officer of the John Hancock Mutual Life Insurance Co., were reprinted in the June 10, 1985 Congressional Record at the request of Representative Barney Frank, a member of this Subcommittee (see Attachment 4). And the Metropolitan Life Insurance Company has frankly stated its intention to become a major provider of financial services.

In sum, of virtually all the activities being considered for possible expansion, the insurance brokerage/agency business appears to be one of the most compatible with the banking industry and one in which no significant safety and soundness risks would be raised.

Also, despite unsupported insurance industry assertions to the contrary, there has never been any evidence presented by that industry that tie-in sales of insurance and other bank products and services, either explicit or implicit, are a common practice.

Many safeguards relating to the offering of insurance are and will continue to be imposed on bank holding companies alone. The public benefits test contained in Section 4(c)(8) of the Bank Holding Company Act (12 USC 1843) would continue to apply to all bank holding companies desiring to sell insurance. This requirement provides protection for the public interest that is not also provided by insurance company regulation. In addition to this requirement, bank holding companies are subject to state-imposed insurance regulations, the Truth-in-Lending disclosure rules covering the sale of insurance in connection with a credit transaction, and the anti-tying provisions of the antitrust laws and Section 106 (12 U.S.C. Section 1972) (1) of the Bank Holding Company Act Amendments of 1970 (P.L. 91-607), which state:

> A bank shall not in any manner extend credit, lease or sell property of any kind, or furnish any service, or fix or vary the consideration of any of the foregoing, on the condition or requirement -
>
> 1) that the customer shall obtain additional credit, property, or service from such bank other than a loan, discount, deposit or trust service;
>
> 2) that the customer shall obtain additional credit, property, or service from a bank holding company of such bank, or from any subsidiary of such bank holding company.

The provisions, by their terms, are applicable to all extensions of credit, leases or sales of property of any kind, the furnishing of any service, and the pricing of any of the foregoing. The anti-tying provisions are unusual in banking law in that they both provide the opportunity for enforcement by the federal bank regulatory agencies, and also provide a specific private right of action to plaintiffs who may have been injured as a result of tie-in sales. Moreover, Section 106(e) of the existing anti-tying provisions authorizes recovery by plaintiffs of treble damages for any violation, as well as the cost of suit and reasonable attorney's fees. This extraordinary remedy is obviously designed both to deter violations on the part of individual banks, and to encourage plaintiffs who may have been harmed by such violations to bring suit for the recovery of damages.

It is instructive to note that the anti-tying provisions that have been in effect for fifteen years have been rarely used by plaintiffs. We believe that the very paucity of their use indicates that they have been successful in deterring bank tie-in sales even when penetration rates are high. In addition, the breadth of the prohibition of tie-ins in the statute ensures that whatever new activity banks may engage in will be subject to these prohibitions. Also, it is a specific responsibility of bank examiners to report any evidence of coercion.

Most of the services provided by banks are also provided by other types of financial institutions. For this reason, any attempt to coerce a customer would result in a customer moving to a competitor. It also makes no sense to jeopardize a customer relationship by using coercive practices to increase just one part of that relationship.

Furthermore, because the insurance industry is also a significant factor in the markets for financial services (e.g., in commercial lending, real estate lending and as investors in corporate securities), there is the potential for conflicts of interest in that industry as well. The recent announcement that Metropolitan Life Insurance Co. will purchase Century 21 Real Estate Corp. the nation's largest real estate sales organization, highlights this fact. Century 21, which has about 6,500 franchise offices and operates in all 50 states, also is active in the fields of insurance, mortgage originations and real estate syndications. Many other industries also have potential conflicts of interest (e.g., the automobile industry). Why should banks and bank holding companies be singled out for special treatment?

We believe that additional competition will lessen the potential for abuse by existing providers of financial services. This conclusion was reinforced by a recent study commissioned by the American Insurance Association, Expansion of Banks Into Insurance, which said that, "deposit-taking institutions generally do not dominate their markets to such an extent that substantial market power could be used to force their way into the markets compelling the purchase of an insurance product by their depositors."

At the same time, however, the McCarran-Ferguson Act precludes the application of such Federal laws and regulations as the antitrust laws to the insurance industry. Thus, the very agents who charged the banking industry, which is by virtue of Section 106 of the Bank Holding Company Act, as well as the general antitrust laws, subject to stringent anti-tie-in provisions, with seeking to promote tie-in sales through the linking of lending and insurance, are not subject to any similar restrictions under the antitrust laws. The insurance industry which hides behind McCarran-Ferguson whenever the possibility of Federal regulation of their activity looms, is at the same time attempting to use Federal law as a club to stop banking's involvement in insurance sales. They can't have it both ways.

We find this position particularly interesting since the 1979 Report of the National Commission for the Review of Antitrust Laws and Procedures stated that, "as presently interpreted, the McCarran-Ferguson Act effectively may immunize from the antitrust laws a broad range of anticompetitive activities which in fact, serve no federal or state objectives." In the process of concluding that, "there is simply no justification for retention of the immunity in its present form," the Commission's report cites a 1977 Department of Justice study that found the benefits of open competition, when compared with prior approval regulation, included less adherence to bureau advisory rates, rates as reasonable or lower than in other states, and greater efficiency in distribution.

The Justice Department study added, "...competition fosters independent pricing, operating stability and flexibility in the pricing structure." The study also compared rates in California (open pricing) versus rates in New Jersey and Pennsylvania (highly regulated rate-setting through state bureaus) as of January 1976. The study found "meaningful price differentials" -- specifically, California auto liability insurance premiums were 10 percent or more below the state-set rates in New Jersey and Pennsylvania. Additionally, where competition was permitted -- e.g., California -- there also was price variation among the various insurance firms.

We believe that the principle of functional regulation contained in several recent legislative proposals would minimize any regulatory conflicts associated with the expansion of banking's insurance activities.

It has been suggested by insurance industry representatives that the insurance services offered by banks and bank holding companies are somehow inferior to the services provided by unaffiliated agents. Agents affiliated with banks or bank holding companies represent the same underwriting companies and offer the same products and services as unaffiliated agents. Moreover, no banker would ever jeopardize a valuable banking relationship by poor insurance service. In its own self interest, a progressive banking organization will give as good or better services as any insurance agency in the area, or it will get out of the insurance business.

Insurance Underwriting

Historically, banking and insurance underwriting have been very closely related. Both businesses involve the solicitation of deposits (premiums) from customers and the investment of those deposits in loans or securities until the need arises to return them to the customer. In fact, to a large extent, life insurance is a less risky business than banking because the existence of advanced actuarial tables can dictate far more reliably the time at which income must be paid out than existing demand deposit and other bank contracts.

Our Association recognizes that because of the specialized expertise required, and the moderately high capitalization requirements, it may be difficult for some banks to enter the insurance underwriting business profitably. The facts that insurance is so specialized a business, that its work force is designed not for retail sales but rather for wholesale sales to a force of insurance brokers, and that most state laws will require separate accounting treatment, capitalization, and regulatory requirements for an insurance underwriting firm, dictate that banks that may wish to engage in this business do so though a separate subsidiary.

For these reasons, our Association strongly urges the expansion of permissible activities for bank holding companies to include the insurance brokerage/agency business and underwriting.

Conclusion

We believe that continuing changes, including the effects of innovation and innovators, the rising affluence of the U.S. economy, and the diverse workings of regulation itself, will result in a more efficient financial services industry. Therefore, our association strongly supports the right of states to regulate bank entry into other lines of business. We also believe that the banking industry should be allowed to offer a broader range of products and services to serve our customers and to permit us to compete with other financial institutions. All of our competitors can offer insurance as one of the financial services they provide to customers. Allowing the banking industry to offer full insurance services would lead to greater convenience and lower costs for users of those services.

Thank you. I would be pleased to answer any questions the Subcommittee may have.

ATTACHMENT I

Let Banks Sell Insurance

Banks think they can sell insurance more cheaply and conveniently than insurance companies. Insurers apparently think so too, for they are fighting an effort by banks in New York State to enter the business. In fact they are going further, asking Congress for a national prohibition against the underwriting or brokerage of insurance by banks.

It's hard to know if the banks' claims are right, or how much of a threat they pose to established insurance companies and agents. But consumers have something to gain and little to lose from increased competition. That's reason enough for New York's Legislature to say yes — and for Congress to stay out of the fight.

The Yellow Pages in every big city offer the names of hundreds of agents and companies eager to sell life, health and casualty insurance. Why add hundreds of banks to the list?

One answer is that banks may indeed be able to sell it cheaper. The market for policies needed by middle-income families is surprisingly uncompetitive. The cost of standardized products like term-life and homeowner's policies varies widely. Some banks would likely take aim at this market, driving down the average cost of basic no-frills insurance.

There's another, better answer: we are asking the wrong question. If banks — or, for that matter, hardware stores — want to sell insurance in a free-market economy, the burden of proving harm ought to rest on those who want to stop them.

Banks are no more likely to default on their obligations than are established insurers. Under the bill before the New York Legislature their operations would be subject to the same rigorous regulation that protects current policyholders. A more plausible objection by the insurance establishment is that banks would take advantage of customers seeking credit. Banks might, for example, tie approval of car loans to purchase of auto insurance.

Such coercive tactics are illegal under New York and Federal law; the opportunity for tie-ins already exists and there is no evidence of abuse. In any case, the proposed law in New York would give customers 30 days to cancel their insurance policies. Thus any borrower who felt coerced could buy the insurance and then cancel afterward, leaving the loan agreement intact.

A bipartisan commission appointed by the New York Legislature recommended that the insurance business be opened to banks. Governor Cuomo has endorsed the recommendation, raising the hopes of people asking the Legislature to stand up to the insurance lobby.

But under legislation proposed in Washington by Senator Dodd of Connecticut, what Albany does would hardly matter. He would effectively deny states the power to give nationally chartered banks the right to broker or underwrite insurance. He argues that his proposal would merely close an inadvertent loophole in a 1982 law. Yet the practical effect of the Dodd Amendment is to limit competition in the insurance industry, headquartered in the Senator's home state. As public policy, some "loopholes" are better than law.

Source: New York Times, June 27, 1985.

ATTACHMENT 2

Insurance Activities of Firms with Nonbank Banks

Shearson/American Express (subsidiary of American Express Company)
American Express Company

Subsidiary: Fireman's Fund Insurance Companies

Subsidiaries: Firemen's Fund American Life Insurance Co.
Interstate Insurance Group
San Francisco Reinsurance Co.
Southern Guaranty Insurance Co.
Wisconsin Employers Group

Kemper Corporation
- American Motorists Insurance Co.
- American Protection Insurance Co.
- Federal Kemper Insurance Co.

Gulf & Western Industries, Inc.

- Financial Services Group
  Associates First Capital Corp.:
  Units:
    - Associates Corporation of North America
    - Cumberland Life Insurance Co. of Tennessee
    - Emmco Insurance Co.

Household International Corporation

Subsidiary: Household Finance Corporation

Subsidiaries: Alexander Hamilton Insurance Co.
Alexander Hamilton Life Insurance Co.

Ben Franklin Insurance Agency, Inc.
Coast-to-Coast Mercantile Agency, Inc. (for employees) (subsidiary of Household Merchandising)
Green Valley Agency, Inc. (subsidiary of National Car Rentals, Inc.)

Teachers Service Organization

Subsidiary: National Teachers Life Insurance Co.

Prudential Insurance Company

Subsidiaries:
- Pruco Life Insurance Co.
- Prudential Property & Casualty Inc.
  - Subsidiaries:
    - Prudential Commercial Insurance Co.
    - Prudential General Insurance Co.
- Prudential Reinsurance
  - Subsidiaries:
    - Essex Syndicate, Inc.
    - Gibraltar Casualty Co.
    - John Street Syndicate, Inc.
    - Pruco Managers, Inc.
- Pruco Syndicate
- Pruco Life Insurance Co.

Continental Corporation

Subsidiaries:
- American Title Insurance Co.
- Old Boston Colony Insurance Co.
- Buckeye Union Insurance Co.
- Commercial Insurance Co. of Newark, N.J.
- Continental Insurance Companies
- The Continental Insurance Co.

Travelers Corporation

Subsidiaries:
- Charter Oak Fire Insurance Co.
- Phoenix Insurance Co.
- The Plaza Corporation
- Travelers Equities Sales, Inc. (Fund underwriter and distributor)
- Travelers Indemnity Co. of America
- Travelers Indemnity Co.
- Travelers Indemnity Co. of Illinois
- Travelers Indemnity Co. of Rhode Island
- The Travelers Insurance Co.
- The Travelers Insurance Co. of Illinois
- The Travelers Life Insurance Co. & Annuity Co.
- The Travelers Life Insurance Co.

E. F. Hutton Group

Subsidiaries:
- E. F. Hutton Insurance Group, Inc.
- E. F. Hutton Life Insurance Co.

Leucadia National Corporation

Subsidiary: American Investment Co. (Consumer Finance & Insurance)

Marsh & McLennan Companies

Subsidiaries: Marsh & McLennan Groups Association (Consumer Ins. Prods.)
Guy Carpenter & Co., Inc. (Worldwide Reinsurance Brokerage)
Marsh & McLennan, Inc. (Insurance Broker)

Dreyfus Corporation

Subsidiary: Dreyfus Life Insurance Co.

Beneficial Corporation

Subsidiaries: American Centennial Insurance Co.
Service General Insurance Co.
BFC Agency, Inc.
BFC Insurance Agency of America
BFC Insurance Agency of Nevada
Central National Life Insurance Co. of Omaha
  Subsidiaries: Northwestern Security Life Insurance Co.
  Economy Assurance Co.
  FTS Life Insurance Co.
  Guaranteed Equity Life Insurance Co.
  Guaranty Life Insurance Co. of America

  Subsidiary: Wasco Insurance Agency

Control Data Corporation (subsidiary: Commercial Credit Company)

Subsidiaries: Commercial Credit Life Insurance Co.
Commercial Credit Insurance Services, Inc.
Certified Insurance Agency of Indiana, Inc.
Gulf Insurance Co.
American Health & Life Insurance Co.
American Health & Life Insurance Co. of New York
Commercial Credit Mortgage Insurance Co.
Atlantic Insurance Co.
Cavalier Insurance Co.
Insurance Co. of the Pacific Coast
Select Insurance Co.

J. C. Penney Co., Inc.

Subsidiary: J. C. Penney Financial Services, Inc. (coordinates insurance activities)

  Subsidiaries: J. C. Penney Casualty Insurance Co.
  J. C. Penney Life Insurance Co.
  J. C. Penney Reinsurance Co.

NBD Bancorp, Inc.

Subsidiary: NBD Insurance Co.

Capital Holding Corporation

Subsidiaries: Capital Enterprise Insurance Group
Commonwealth Life Insurance Co.
Georgia International Life Insurance Co.
Home Security Life Insurance Co.
National Standard Life Insurance Co.
Peoples Life Insurance Co.

Aetna Life & Casualty

Subsidiaries: Aetna Casualty & Surety Co.
Aetna Life Insurance & Annuity Co.
Aetna Reinsurance Co.
Automobile Insurance Co. of Hartford
Standard Fire Insurance Co.

Merrill Lynch & Co.

Subsidiary: Family Life Insurance

Sears, Roebuck & Co.

Allstate Insurance Co.

I.T.T. Corporation

Subsidiary: Abbey International Corporation
Hartford Fire Insurance Co.
I.T.T. Life Insurance Co.

Bancorp Hawaii Inc.

Subsidiaries: Bancorp Insurance Agency of Hawaii, Inc.
Bancorp Life Insurance Co. of Hawaii, Inc.

Washington National Corporation

Subsidiaries: Archol National Life Insurance Co.
Washington National Insurance Co.
  Subsidiary: Washington National Life Insurance Co. of New York

Integrated Resources, Inc.

Subsidiaries: Dascit/White & Winston, Inc. (Life insurance Agency)
Underwriters Service Agency, Inc. (Life insurance Agency)
Underwriters Service Agency Insurance, Inc. (Life insurance Agency)
Underwriters Service Agency of New Jersey, Inc. (Life insurance Agency)
Integrated Resources Insurance Services, Inc. (Life insurance Agency)
The Merkin Companies, Inc.
Pension Associates, Inc.
Providence Life Insurance Co.
Resources Life Insurance Co.
Underwriters Service Agency Northwest, Inc.
United Economic Services, Inc.
United Service Agency-West Insurance

Teledyne, Inc.

Member Companies: Argonaut Insurance Co.
Coastal Plain Life
General Life Insurance
Great Central Insurance
Pyramid Life Insurance
Trinity Universal Insurance
Untied Group Insurance
United Insurance Home Service

Greater Providence Deposit Corporation

The Resistant...to a limited extend provides diversified financial services such as specialized insurance brokerage and stock brokerage. (10-K report, p. 4)

Subsidiaries: Greater Providence Trust Co.
Community Financial Services Corporation
Community Loan & Investment Bank
Dominion Financial Corporation

IDS Financial Services, Inc. (Subsidiary of Alleghany Corporation, New York, NY)
Alleghany

Subsidiary: Investors Diversified Services, Inc. (Minneapolis, Minn.)
  Subsidiary: IDS Life Insurance Co.
    Subsidiary: IDS Life Insurance Co. of NY

Lincoln National Company

Subsidiaries: American States Insurance Co.
  Subsidiary: American Economy Insurance Co.
American States Co. of Texas
American Preferred Insurance Co.
American States Life Insurance Co.
American Union Insurance Co. of New York
Chicago Title Insurance Co. (subsidiary of subsidiary Chicago Title & Trust Co.)
  Subsidiary: McHenry County Title Insurance Co.
  W.W. Vincent & Co.
Insurance Co. of Illinois
Lincoln National Life Insurance Co.
  Subsidiary: Lincoln National Pension Insurance Co.
Lincoln Life Improved Housing, Inc.
Lincoln National Sales Corporation (Life Insurance Products)
Security Connecticut Life Insurance

Columbia Management Co.

Subsidiary: Columbia Life Insurance Co.

Chrysler Corporation

Subsidiary: Chrysler Insurance Co.
Chrysler Life Insurance Co.

Mutual Benefit Life Insurance Co.

Subsidiary: MBL Life Assurance Co.

Thomson McKinnon Securities, Inc.

Subsidiary: TMSI (Sells life insurance and on selective basis, it has entered into dealer agreements with certain insurance distributors covering a representative list of life and annuity products. Approximately 700 of TMSI's account executives are licensed in their respective states to sell insurance.)

Franklin Resources

Subsidiary: Franklin Agency, Inc. (Insurance agency distributing annuities through brokers to the consumer)

Sources: Securities and Exchange Commission 10-K Report filings and the 1984 Directory of Corporate Affiliations: "Who Owns Whom."

Firms For Which No Information Was Found

Fidelity Management & Research Corporation, Boston, Mass.

Wellington Management Co., Boston, Mass.

McMahan Valley Stores, Carlsbad, Calif.

Trust Management Corporation (Rollert & Sullivan, Inc.), Boston, Mass.

Principals of the Templeton Group of Mutual Funds, Nassau, Bahamas

Individuals Associated with the Reserve Fund, Inc.

Dimension Financial Corporation, Denver, Colo.

Wilmington Trust Co., Wilmington, Del.

Bear Stearns & Co., New York, N.Y.

Bessemer Group, Inc., New York, N.Y.

Olympian Bancorp, San Diego, Calif.

S.F.C. Holdings Corporation, Honolulu, Hawaii

Dawson Corporation, Lexington, Nebr.

Mutual Savings Co., Ltd., Omaha, Nebr.

Hawaii Resort Industries, Inc., Honolulu, Hawaii

Denver, Inc., Schuyler, Nebr.

Servco Pacific, Inc., Honolulu, Hawaii

Finance Enterprise, Ltd., Honolulu, Hawaii

Realty Investment Co., Ltd., Hilo, Hawaii

Aloha Corporation, Honolulu, Hawaii

Tomar Financial, Orange, Calif.

Western Interstate Bancorp, Irvine, Calif.

WKS, Inc., Fresno, Calif.

MTB Corporation, Oakland, Calif.

Nevada First Development Co., Reno, Nev.

Douglas Bancorporation, Inc., Parker, Colo.

The Capital Group Inc., Los Angeles, Calif.

The Ohio Co., Columbus, Ohio

Corporation Service Co., Wilmington, Del.

Frank Russell Co., Tacoma, Washington

J. & W. Seligman & Co., New York, N.Y.

T. Rowe Price & Associates Inc., Baltimore, Md.

J.J.B. Hillyard, W.B. Lyons Inc., Louisville, Ky.

Brown Brothers Harriman & Co., New York, N.Y.

NAFCO Financial Group, Inc., Naples, Fl.

ATTACHMENT 3

Protect This Insurance Triumph

Some 700,000 New Yorkers buy life insurance from the Savings Bank Life Insurance Fund, and no wonder. It's cheap, uncomplicated and sold without high-pressure tactics. But S.B.L.I. has one serious drawback: By state law, coverage is limited to $30,000. Raising that ceiling is long overdue.

New York permits banks to rent lobby space to insurance companies. But only savings banks are allowed to sell and underwrite life insurance, and only because of a brief reign of consumerism in Albany in the late 1930's. Correctly convinced that lower- and middle-income people were being victimized by unscrupulous insurance agents, Gov. Herbert Lehman persuaded the Legislature to charter an independent insurance company jointly owned by state savings banks.

S.B.L.I. has been a remarkable success. In the early years, it broke the hold of "industrial" insurance, the incredibly expensive small burial policies that were peddled door to door. Today it still guarantees fair value to less sophisticated consumers and provides a price benchmark for the more ambitious who want to comparison-shop. But S.B.L.I. has had to fight a permanent political war with the rest of the insurance industry to stay in business, and in recent years that industry has been winning. The size of the maximum policy has been frozen at $30,000 since 1967, while the cost of living has tripled. Anyone in need of insurance must look beyond S.B.L.I. for adequate coverage.

A vote is scheduled in the Assembly next week on a bill to raise the coverage limit to $100,000. That's the very least the Legislature can do to defend S.B.L.I., a triumph for consumers, from an insurance lobby eager to bury it.

Source: New York Times, June 16, 1985.

ATTACHMENT 4

EXTENSIONS OF REMARKS

GENUINE COMPETITION FOR FINANCIAL INSTITUTIONS

HON. BARNEY FRANK

OF MASSACHUSETTS

IN THE HOUSE OF REPRESENTATIVES

Monday, June 10, 1985

● Mr. FRANK. Mr. Speaker, as a member of the Committee on Banking, Finance and Urban Affairs, I have been distressed at what seems to me an insufficient commitment to genuine competition on the part of many of our financial institutions. Too many of those in the financial services industry pay lip service to competition in general, but strike anticompetitive postures when it is suggested that increased competition in their own lines of business would be beneficial.

One very noteworthy exception to this not-for-me approach to competition comes from the John Hancock Mutual Life Insurance Co. On May 6, 1985, E. James Morton, president and chief operations officer of the John Hancock, made a superb speech on the subject of genuine financial deregulation which expresses a viewpoint which seems to me to be in the best interest of consumers and the economy as a whole.

I want to congratulate Mr. Morton for his courageous and thoughtful presentation, and I ask that his remarks on this subject be reprinted here.

FINANCIAL SERVICES DEREGULATION: A NECESSITY FOR THE INSURANCE INDUSTRY

(By E. James Morton)

Thank you. It's a pleasure to be here today, and I'm delighted to have this chance to deliver an important message to my colleagues in the life insurance industry, as well as to you—and that is that life insurance companies are in serious danger of being excluded from the emerging financial services industry not only because of unfair regulatory policies"but also because of our own shortsightedness. Now let me expand a little on that theme.

Existing regulatory policies severely restrict life insurance companies from entering banking, residential real estate brokerage and other services. And we continue to be restricted even as regulatory doors are being opened to banks and many other financial service providers.

Besides being patently unfair, that is clearly bad public policy. Yet, for reasons I don't totally understand, life insurance people have done almost nothing about this discrimination or to make their case to the people who hold our fate in their hands—Congress and the Federal regulatory agencies.

Banks, brokerage firms, and others are rapidly expanding their products. Some of them are lobbying hard for laws and regulations which will let them expand and diversify. We understand that approach. But John Hancock would rather see changes in the current system to give all players a fair opportunity to compete.

I don't think the life insurance industry is serving its own interest by trying to stop the obvious and natural evolution of the marketplace. We certainly can't rely on any other industry to protect us, or to include us in their deregulation proposals—and we shouldn't expect them to. We have to fight our own battles for equal treatment and opportunity. At the John Hancock we are engaged in that combat, and we sure would appreciate some help from our colleagues.

Also, at the risk of seeming like an ungrateful guest, let me say that I believe the media has practically ignored the role of life insurance companies in the deregulation issues. Of course, that may be our own fault because we have done such an amateurish job of explaining our role and our needs.

Everyone has heard about the diversification programs of Citicorp, Merrill Lynch, American Express, and Sears Roebuck. But they have heard very little about the life insurance companies, even though deregulation is the major issue which we face, because in an increasingly deregulated environment, the future of most life insurers probably lies either in filling specialty niches or in diversifying. And in case you haven't guessed, the John Hancock has chosen the latter course, diversification.

We were founded in 1862, during Abraham Lincoln's first administration. For a century we sold life and health insurance, and did very well. And, we continue to sell insurance. But over the past 15 years we have moved into the middle of the financial services revolution. We have added mutual funds, stock brokerage, tax shelters and property and casualty insurance to our products, and we regard our competitors as Sears, and Merrill Lynch, and Citicorp and American Express.

I'm almost old enough to remember the days when American Express was a delivery company whose principal business was moving packages quickly in horse-drawn wagons. Today with its wide array of diversified services—from travelers checks to securities brokerage—one of the principal businesses of American Express is moving money.

We are not playing dead in the face of that competition. We are competing, and we intend to compete ever more aggressively, in this brave new world. I personally believe that deregulation is a good thing—both for consumers and for financial service providers—and the more deregulation we get the better off we will all be.

I sadly acknowledge, however, that such an enlightened view has not increased the John Hancock's popularity among our friends in our own industry. We stand virtually alone among life insurance companies in favoring continued financial services deregulation.

To many—to too many—in our industry, the burning issue of the day is not how to get into the banking business but rather how to keep the banks out of the life insurance business. Many life insurance companies have suggested they are willing to stay out of banking if that's the price they must pay to keep banks out of insurance. At the John Hancock, we couldn't disagree more.

The marketplace—and by that I mean the people who buy financial products—has identified the integrated financial services provider as meeting the needs of people and offering the convenience which they have come to expect in their daily transactions. Five to ten years from now, whether we like it or not, Citicorp and other financial services giants will be offering just about every financial service that there is—including life insurance. The erosion and eventual elimination of barriers to financial services integration are inevitable. It's time for the life insurance industry to wake up and accept that fact. Rather than being obsessed by the banks as evil competitors out to do us in, we should be using this time to prepare for the increased competition that surely lies ahead. And we must use this time to educate the Congress and regulators about our existence and our needs, so that life insurance companies do not end up being second-class citizens. Surely, if we are afraid of the competition of banks in our business, the best defense is for us to be able to offer banking services to our own customers.

To me, it doesn't seem like reasonable public policy to let a major industry dry up slowly because it cannot compete on equal terms. Yet, that is exactly where regulatory policy appears to be heading today with respect to life insurance.

While companies like Merrill Lynch, American Express and Sears Roebuck have been allowed to offer a wide variety of financial services inside their corporate complexes, the John Hancock has encountered regulatory resistence to a simple acquisition of a Savings and Loan institution—even though no one doubts our integrity of our demonstrated skill in providing financial services including mortgage lending to consumers. For the past year, we've been trying to acquire a Savings and Loan Holding Company in Columbus, Ohio (which I am happy to tell you, is Federally insured). We have a Purchase Agreement. We have submitted our application to the Federal Home Loan Bank Board and the Massachusetts Insurance Commissioner. But for the past year, our application has languished at the federal level because one of our subsidiary companies is a regional securities firm. And yet there is no federal law prohibiting the common ownership of a securities firm and a federal Savings and Loan. The affiliate restrictions of the Glass Steagall Act do not apply. But still out application remains in limbo. More recently we have filed to start a consumer bank in New Hampshire. Perhaps we will have better luck with that venture.

In any event, if we are to compete in the emerging financial services marketplace—and we have every right to do so. . . . And if we are to hold ourselves out to consumers as a diversified financial services organization, then we must offer banking services . . . as well as insurance services and securities brokerage services and credit card services and real estate services and all the rest. It's just as simple as that.

Unfortunately, the marketplace always moves faster than regulatory or legislative action. And today the financial services business, aided by technology, has evolved far beyond the old regulatory system which tried to pigeonhole the various segments of financial services into distinct and separately owned companies. When a sharp change in market practices occurs before a corresponding change in legal philosophy and structure can be devised, then two things happen. First, those companies which can find a way to maneuver around the old structure will do it and gain an artificial competitive advantage. And, second, the reg-

● This "bullet" symbol identifies statements or insertions which are not spoken by the Member on the floor.

ulators trying to enforce outmoded laws have no clear guidance for dealing with the new situation. That's where we are now.

What makes sense to us is a functional regulation system in which each sector of the financial services market—banking, life insurance, securities brokerage, etc.—is regulated separately. Organizations would be free to enter any or all segments, but would be subject to regulation in whatever segments they participate—segment by segment.

It's absolutely understandable and reasonable that regulators need to be assured of financial market safety. I've worked in a regulated environment all my life, and I know that we can live with any reasonable restrictions to prevent abuse. But regulation which seeks to stop that abuse by preventing common ownership of companies that offer the separate parts of the financial services market is foolish and anticompetitive—and furthermore, as we have seen, ineffective.

I find it fascinating that Sears Roebuck—a retail merchandising company not subject to financial services regulation—has long had very successful property and casualty and life insurance subsidiaries, and a California Savings and Loan, and has more recently acquired a major full-line securities firm, a major national real estate firm and a Delaware consumer bank. While the life insurance industry goes about fighting the banks, and the regulators try to decide what they want to do about the question of common ownership of diversified financial companies, Sears and other competitors go about the more productive task of creating full financial services complexes.

As Sears has already proved, the diversified financial services company is here right now. So the problem is not how to maintain artificial and discriminatory and exclusive barriers. The real problem is how to develop even-handed regulation that gives equal opportunity to all types of financial institutions regardless of their historic origins, and that includes life insurance companies.

Unfortunately, most of the new frameworks that are being proposed favor one industry or another and most often the banks. Most proposals give little or no recognition to the insurance industry. For instance, the proposal backed principally by the Reagan administration and which has its genesis in Treasury Department recommendations is bank oriented and offers very little to the life insurance industry.

So our major effort at the John Hancock is to work uniform regulation. But, making our voice heard is not easy. When I visit Washington, I have to remind people that we even exist, before I can make our case. That's because we are regulated at the state level, and so there is no agency in Washington with extensive knowledge of our business. So, we have no federal champion of our cause in the financial service debate. We constantly face the need to educate federal policymakers about our business in order to receive any consideration in the various deregulation bills. (Unless we as an industry do a much better job than we have been doing, we are very much at risk of being frozen out as Congress struggles to devise an equitable regulatory policy.

Unlike most other insurance companies, the John Hancock would gladly accept federal regulation of our industry—*if* it provided full access to the financial services market and preempted the state restraints on diversification. Anyway the federal government already has a substantial influence on our business, despite the fact that we are a state regulated industry. Federal tax law influences our product design besides dictating our tax payments. The SEC regulates some of our products. ERISA governs still others. And the coming congressional overhaul of financial services regulation will clearly shape the future of our business—whether by design or by inadvertence. The time has surely come for a comprehensive federal approach to financial services regulation which addresses the key issue—and that is reciprocal market access for all financial service providers, including mutual life insurers.

And with that word mutual, let me say that for mutual companies such as us, the road to full financial services is really rocky. Although mutual companies have 50 percent of life insurance industry assets, the mutual form of organization is confusing to and misunderstood by federal regulators. Many of the federal deregulation proposals making the formation of an upstream holding company a structural prerequisite. And yet because a mutual life company is [illegible] by its policyholders, an upstream holding company is impossible in the mutual form of organization. And furthermore, conversion from the mutual form of organization to a stockholder owned structure is not the panacea its advocates suggest. Some states make no provision for conversion, Massachusetts being one that's somewhat significant for us. And without a wholesale reappraisal of these state insurance conversion laws which do exist, insurers trying to become stock companies may find themselves so debilitated by the cost of the reorganization as to be unable to compete effectively once the process is completed. John Hancock and its policyholders have been well served over the years by the mutual form of organization. We are not going to discard this structure casually—merely because Congress failed to make provision for mutual life companies in their regulatory framework.

Well, with all these very serious problems, it would be nice if our friends in the insurance industry would join us in seeking fair treatment in Congress. So far, we haven't had a hell of a lot of success. There are a lot of people in the closet, but they only open the door once in a while and say, "Don't tell anybody, but we think you're right."

One of the few companies that does publicly agree with us is not a life insurer but a bank.

In testimony before a House Subcommittee, Citicorp's David Wagstaff said quote . . . "Citicorp does not support restrictions on insurance companies and others who wish to enter the market for banking services as long as they do so on an equal basis." End quote.

Well, hooray for David Wagstaff and Citicorp. But what we really need is some support from the regulators—both our state regulators and those in Washington.

Now there are some people who question whether insurance companies are confident and aggressive enough to compete with banks as they come into our markets. I'm not too worried about that. Take Savings Bank Life Insurance for instance, which is aggressively promoted in Massachusetts, Connecticut and New York. It represents only about 3 percent of all life insurance sold. And I've never seen long lines of people waiting outside savings banks in Boston to buy life insurance.

There's an old but true cliché in our business: Life insurance is sold, not bought. Almost invariably, an agent is the essential catalyst. The agent must first identify a client's needs and then motivate the client to buy life insurance to meet those needs. In assessing our own strengths, we come back constantly to our sales organization. It's highly motivated and trained, and is supported by strong marketing services. But most important, it has loyalty and a long tradition which cannot be duplicated, or acquired or purchased overnight.

But unlike some other financial services providers, we don't view the future in terms of an integrated financial services complex where clients deal with a single sales person for all their needs. We do look for integration wherever possible. We own Tucker Anthony and R.L. Day, a regional brokerage firm which is expanding nationally, and there are significant synergies between Tucker Anthony and our life insurance operations. For instance, John Hancock agents are now selling tax shelters created by Tucker Anthony, while Tucker Anthony brokers are selling John Hancock annuities.

But mostly we anticipate that each of our financial service segments will operate separately and attract its own primary clients. Those clients will then become prospects for other John Hancock products and services.

Let me conclude by saying the time has come for the life insurance industry to wake up and accept the reality of today's financial services marketplace. The question is not whether deregulation is here to stay. That's a fait accompli. The real question is whether life insurance companies will be excluded from the emerging financial services marketplace or given a chance to participate. We have to let Congress, the regulators and you know we exist and to insist everyone recognize our needs.

At John Hancock, we will not give up our struggle for equality. We intend to be major participants in the emerging financial services industry as those regulatory walls come tumbling down. ■

Chairman **St Germain**. Mr. Ryan, I want you to know that I was most impressed. In the old days in London, people would gather in the sitting room and have very erudite conversations in very elegant language. I was impressed by the delicate phrasing that you used in referring to the insurance industry and insurance agents—you were so genteel.

Mr. **Ryan**. Thank you, Mr. Chairman.

Chairman **St Germain**. Now we will hear from Frank A. Rauscher, who represents the Consumer Bankers Association.

Mr. Rauscher.

STATEMENT OF FRANK A. RAUSCHER, EXECUTIVE VICE PRESIDENT, SUBURBAN BANK, BETHESDA, MD, ON BEHALF OF THE CONSUMER BANKERS ASSOCIATION

Mr. **Rauscher**. Mr. Chairman and members of the committee, I am Frank Rauscher, executive vice president of the Suburban Bank in Bethesda, MD. I appreciate the opportunity to appear today on behalf of the Consumer Bankers Association, which represents federally insured financial institutions on retail banking issues.

Today's hearing addresses an unusual and unique situation in the State of South Dakota. The committee is familiar with the origins of that State law, with the attempted entry of an out-of-State bank holding company, and with the August 1 denial by the Federal Reserve Board of that holding company's application.

The question you have posed, whether it is sound policy for a State to prohibit certain activities by its banks in the home State, yet permit them to conduct the same activities in other States, is a difficult one. In all candor, we have questions about such an arrangement.

But we have much greater concern over some of the proposed methods to close the loophole.

The most extreme approach is to extend coverage of the Bank Holding Company Act to State-chartered banks. This goes far beyond closing the South Dakota loophole. It is also a startling override of State authority that should be considered only in the context of a comprehensive review of the dual banking system.

In point of fact, the loophole has been effectively closed by the Federal Reserve; there is no compelling reason to pass legislation because the situation is largely moot for now.

Instead, we would ask that you use this issue to look at the broader public policy questions of permitting financial institutions both banking and insurance powers. How many years have to pass before it is finally acknowledged that an overlap has already occurred? What are the pitfalls, if any, to the public? Most important, what are the consumer benefits of allowing banks into the insurance business?

Three major considerations come to mind.

First, there already has been a significant movement of the insurance industry into banking and financial services. We do not condemn this, because the marketplace is evolving according to consumer demand. There are numerous insurance companies who have responded to their customers' needs by offering a diversified product line, including bank-like products and services.

However, the policy question is whether a continued one-way separation is justified to prevent bank expansion into insurance. We believe this separation is antiquated.

Second, what does the consumer want and how will he benefit?

Surveys show that consumers would like the option to conduct their insurance business through a bank. This is part of the one-stop shopping phenomenon. One survey found 59 percent of its respondents think banks would do a good job of providing one-stop financial services. Another survey found that most people, 67 percent, prefer point-of-sale alternatives, such as banks, brokerage firms, and department stores.

Therefore, we believe consumers would like to buy insurance from banks and we think increased competition will lead to lower rates.

Actual experience is sometimes the best indicator of consumer benefits. Suburban Bank, my own institution, for example, has been offering insurance products for over 30 years through our grandfathered subsidiary. We recently structured a rate comparison on automobile policies with four well-known major low-cost direct writer insurance companies in 10 regions of Maryland. Our rates were more favorable to the consumer in 73 percent of these cases. While our rates cannot speak for other banks, this is not theory, it is a concrete, real life example.

Third, there are 1,400 State-chartered commercial banks providing general agency services, serving as valuable and trusted sources for both insurance and banking for their communities. Sixteen States actively permit agency and brokerage powers for their State-chartered banks. These banks are not guilty of wrongdoing. There is no reason to deny their customers the opportunity of choice or the benefits of continued competition instead of less competition.

For these reasons, the CBA feels legislation is necessary, but not to close the South Dakota loophole. Rather, we would prefer a modernization of existing law to open insurance for banks and permit a more uniform offering of services by all financial providers.

Thank you, Mr. Chairman.

[The prepared statement of Frank A. Rauscher on behalf of the Consumer Bankers Association follows:]

Testimony of

Frank A. Rauscher

on behalf of

The Consumer Bankers Association

before the

Subcommittee on Financial Institutions,

Supervision, Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

September 11, 1985

Mr. Chairman, my name is Frank Rauscher. I am Executive Vice President of the Suburban Bank of Bethesda, Maryland, and I am appearing today on behalf of the Consumer Bankers Association. /1

We would like to thank the Chairman and the Committee for this opportunity to testify on an issue of great concern to our members: the current relationship between the banking and insurance industries and the legal framework, both state and federal, which governs them.

The CBA has for some time had a task force on insurance, on which I serve, which strongly advocates the expansion of banking into insurance at all levels.

Today's hearing addresses an unusual and unique situation in the state of South Dakota. Members of the Committee undoubtedly are familiar with the original state law there, in which the state legislature set the conditions under which state-chartered, state-regulated banks could engage in the insurance business.

1/ The Association is a nonprofit organization that was organized in 1919 to provide a voice for the retail banking industry. Today, membership in the Association is open to any federally insured depository institution, including commercial banks thrifts, and credit unions. Associate members include bank card processors and service provider organizations. Combined, the members of the Association now hold over 70% of all consumer credit outstanding held by commercial banks and over 80% of the consumer deposit accounts held by commercial banks.

The Committee is also familiar with the subsequent attempt by an out of state holding company to purchase a state bank there for the purpose of selling insurance in the forty-nine other states.

And you are familiar with various proposals in the Congress to intervene in the situation. Some proposals would simply require that insurance and other powers granted to a state bank be exercised in that home state. Other bills have addressed the "loophole" by extending coverage of the Bank Holding Company Act to all bank holding company subsidiaries, including state banks. This last approach is particularly repugnant to the CBA. It would prohibit states from permitting their institutions to offer products and services that are demanded by their residents. It is a startling override of state authority that should only be considered in the context of a comprehensive discussion of the dual banking system.

On the other hand, the question you have posed, Mr. Chairman, - whether it is sound policy for a state to preclude banks chartered by it from conducting certain activities in that state, yet permit those same banks to conduct such activities in other states - is still a difficult one.

In all candor, we have questions about such an arrangement. But at the same time, the CBA does not believe that legislation is necessary, since the Federal

Reserve Board on August 1, 1985, denied the application of an out of state holding company to purchase a South Dakota bank. The situation has, in fact, been resolved.

More central to this hearing and this issue is the broader policy question of permitting institutions both banking and insurance powers. Should they be allowed to overlap? Is this overlap already occurring? What are the potential benefits to the consuming public? What are the potential pitfalls, if any? Is the current inconsistent federal separation still justified, or is it outdated? Is there any evidence or body of experience to show what happens when banks enter the insurance business? And finally, should Congress preempt existing state banks' insurance powers, or expand those powers for all banks?

First, the existing state of competition and the increasing intrusion into banking by insurance entities should be noted.

The Competitive Environment

The financial services marketplace is characterized by ever-increasing inter-industry competition and by a general trend toward integration between the insurance, banking, securities, real estate, and retailing industries. While other financial services institutions, such as Sears, Merrill Lynch, Prudential-Bache and Shearson--American Express are permitted to enter traditional banking markets, regulatory constraints preclude commercial banks from competing for the consumers' financial business by providing a full line of products and services to satisfy their needs. Furthermore, many of the financial products provided by these competitors are functionally and practically similar. For example, a whole life insurance policy is similar to a tax-deferred savings account and a variable life policy is a form of tax-deferred money market fund. Both insurers and banks offer IRA/Keogh accounts, savings certificates at money market rates, consumer and commercial loans and a growing variety of other financial products and services.

In addition, bank competitors are packaging diverse forms of financial products and offering them in convenient one-stop shopping centers. This is part of a growing trend to provide banking, credit, insurance, securities and real estate services in retail stores.

For example, J.C. Penney, Montgomery Ward, Kroger and K-Mart, as well as Sears are selling insurance and other financial products in their stores and supermarkets. Unless banks are permitted to offer the same variety of financial services, competition from less restricted firms will attract a growing share of traditional bank customers. We should remember the lessons of Regulation Q constraints on interest rates. When the money market funds offered the public market rates of interest on their savings, billions of dollars in deposits flowed out of bank accounts, and many consumers found that they could obtain bank services from securities firms, insurance companies and other providers.

One of the major areas of the financial services market barred to banks and bank holding companies is the general business of insurance. At the same time, leading insurance companies have for some time been positioning themselves to meet customers' demands for comprehensive financial services. Insurance companies, securities firms, retailers and others are now leveraging existing customer relationships by expanding into related financial services and cross-selling their products and services.

Today, insurance companies offer their customers a growing variety of banking, investment and real estate services. For example, Prudential-Bache cross-sells products using referrals from its insurance agents, to offer home mortgages to policy holders and investors. Table 1 provides further examples of the integration of insurance and banking.

Table 1

Examples of the Expansion of Insurance into the Financial Services Industry

o The Travelers Insurance Corp. owns an FDIC insured commercial bank, the Massachusetts Companies, and Brokers Mortgage Service, Inc., a firm that originates, sells and services home loans.

o Prudential owns Prudential Bank and Trust, a securities firm (Bache) and a real estate company. It has also entered the home mortgage market.

o New England Mutual Life acquired a savings bank.

o Metropolitan Life which is already selling insurance directly, will soon be selling mortgage loans, insurance and other financial products through its new Century 21 subsidiary.

o Equitable Life will sell life, health and annuity insurance in Bank of America branches.

o Aetna Life & Casualty sells insurance in Tennessee bank branches via an independent insurance agency.

o Mutual Benefit Life owns Mutual Benefit Trust, R.I.

o Northwestern Mutual Life is buying a major share of M&I Corp., a $3.4B asset bank holding company in Wisconsin.

o Allstate Insurance is owned by Sears, which also owns two banks and a S&L, a major investment house (Dean Witter), and a real estate company (Coldwell Banker). Sears has over 300 financial centers nationwide offering the products of these subsidiaries to store customers.

o Family Life Insurance is owned by Merrill Lynch, which also owns a bank and a real estate firm.

o Fireman's Fund and IDS insurance companies are owned by American Express, which also owns two banks, a mortgage company, and a securities firm (Shearson).

o J.C. Penney Life and First National Bank of Harrington, Del., are owned by the retailer. The department store chain sells its insurance products in hundreds of stores nationwide.

o Acacia Mutual Life owns a discount brokerage, and operates a mutual fund and Acacia Federal S&L, Va.

o Capital Holding Corp. owns National Liberty Insurance, First Deposit Life Insurance, First Deposit National Bank, N.H., and First Deposit Savings Bank, Ca.

o Hutton Life, Hutton Trust Co., and E.F. Hutton Bank are owned by E.F. Hutton.

o Alexander Hamilton Life is owned by Household International, which also owns Valley National Bank and three savings and loan associations.

o American Centennial Insurance, Central National Life and Beneficial National Bank are owned by the Beneficial Corp.

o Both Cumberland Life and Associates National Bank are owned by Gulf and Western Corp.

o Paul Revere Insurance, six other insurance companies and Anaheim National Bank are owned by AVCO.

o Leucadia National is an insurance holding company that owns Charter National Life and American Investment Bank, Vt.

o American Title Co. is owned by Glendale Federal S&L Association.

o John Alden Life and United Fidelity Life Insurance Companies are owned by Great Western Financial Corp., a S&L holding company.

Despite the rapid expansion by insurance companies into the banking business, most insurers and agents strongly oppose efforts by banks to offer insurance products. One reason given for such opposition is that banking and insurance have traditionally remained separate and should continue to be kept apart. But the realities of the marketplace have blurred outmoded distinctions between providers of financial services. The integration of insurance and banking cannot be denied or reversed, since it is in response to the demands for a complete line of financial products and services, that can satisfy consumer's individual needs.

Another reason for opposing industry integration is the fear that economic resources will become concentrated. This argument cannot be supported, for several reasons. The banking industry, with some 15,000 competing institutions, shows no signs of concentration. Neither does the insurance industry with 5,000 companies.

If anything, the insurance industry is more concentrated, both in numbers of companies and in shares of the market held by the largest companies (see Table 2).

As noted earlier, the integration of insurance and banking that has already taken place has not resulted in any measurable concentration of resources. Furthermore, the banking and insurance industries are thoroughly regulated, both by government agencies and by the competitive environment that characterizes the two industries. These factors should provide more than adequate assurances for those who fear that bank entry into insurance will adversely affect the public interest.

Unlike those who are trying to prohibit inter-industry competition, we do not favor restrictions on other financial services providers that wish to offer deposit products, loans and other banking services. To the contrary, we welcome competition between insurance companies and banks, so that they may provide the best

TABLE 2

COMPARARATIVE INDUSTRY CONCENTRATIONS

10 LARGEST FIRMS' SHARE OF INDUSTRY TOTAL BASE

Concentration Rank	Industry	No. of Companies	Top 10 Share of Total Industry	Base	Total Base ($ Billions)
1.	Securities Industry	339	54.4%	Capital	$11.6
2.	Life Insurance Cos.	2,060	50.2%	Assets	$588.2
3.	P&C Insurance Cos.	2,953	34.5%	Assets	$251.2
4.	Savings Banks	424	29.5%	Assets	$174.2
5.	Commercial Banks	14,452	20.3%	Assets	$1,876.1
6.	Savings & Loans	3,342	13.1%	Assets	$686.2

Sources:

Life Insurance Fact Book
A.M. Best
NAMSB National Fact Book
FDIC
FHLBB

financial products and services at the lowest cost. In the interest of fairness, we ask for competitive parity between all segments of the financial services industry. The consumer will be the major beneficiary of open competition.

Consumer Benefits

In the dispute between the insurance and banking industries over the financial services market, consumers' needs and wishes have been virtually ignored. Yet, numerous surveys and actual market experience provide substantial evidence that the public would welcome the opportunity to obtain insurance from their banks.

For example, a recent study sponsored by the Federal Reserve Board and the Comptroller of the Currency showed that 6.5 million households would purchase property and casualty insurance from banks, and that 11 million households are interested in buying life insurance from banks and thrifts. /2

A recent survey of consumers by the life insurance industry found that 59% of respondents believe that banks would do a good job of providing one-stop financial services (including insurance) compared to only 16% for

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2/ Survey of Consumer Finances, Mathematica Information Services, November, 1984.

life insurance companies. Consumers rated banks highest in terms of quality of service, respect for individual privacy, treatment of people as individuals and giving people their money's worth. The survey also found that many respondents would prefer to purchase life insurance from a life insurance department in their banks or a one-stop financial center, rather that from an agent. /3

Another consumer survey sponsored by insurance companies, banks and others found that while 33% of consumers prefer to purchase insurance from insurance companies, most (67%) prefer such alternative sources as banks, brokerage firms and department stores. Among those who prefer other ways to purchase insurance, nearly half said they would like to purchase life insurance and homeowners insurance at a financial services center compared to 45% for auto insurance. /4

While numerous surveys show various levels of interest by consumers in obtaining insurance from banks, actual experience is often a better guide to future attitudes and behavior. For more that a century, small banks have been involved in selling or underwriting insurance. For example, banks in Minnesota, North and South Dakota, and Colorado have been offering general

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3/ The 1984 MAP Survey, American Council of Life Insurance, October-November, 1984.

4/ Insurance Distribution Alternatives in the 1980s, Response Analysis Corporation, December, 1984.

insurance agency services to consumers for decades. Insurance agency and brokerage activities are currently authorized for state-chartered banks in 16 states. Today, over 1400 state-chartered commercial banks provide general insurance agency services. /5 Consumers have found banks in these states to be a valuable and trusted source of insurance and banking services.

Let me offer some personal experience to further illustrate the point. My institution, Suburban Bank, has begun offering insurance in the Maryland area. While our rates do not necessarily represent those to be expected of other banks, the committee might be interested in some concrete, real life rate comparisons.

Suburban Bank has had as its subsidiary Suburban Insurance Incorporated since the early 1950's. Acting as agent for the Reliance Insurance Company, we can offer auto, homeowners, business, boat and other insurance which is competitive or superior in rate to that of several major insurance companies. Table 3 shows our rates and those of four other companies for 2 types of auto policies, broken down by ten geographic areas in Maryland. Of the 74 comparisons, we offer equal or lower rates in 54 -- 73% of the time.

5/ Banks in Insurance: The Real Issue, Transition, May 1984.

TABLE 3

MARYLAND AUTO PREMIUM COMPARISON - 2/1/85

	SUBURBAN/ RELIANCE	U.P. 10/84	GEICO 2/84*	STATE FARM 5/84*	ALLSTATE 4/84*
Territory 01 - Baltimore					
POLICY A	$ 565	$ 574	$ 545	$ 560	$ 764
POLICY B	1,135	1,152	979	1,080	1,366
Territory 02 - Baltimore Suburban					
POLICY A	415	422	390	454	486
POLICY B	812	826	679	872	864
Territory 08 - Montgomery County Outer Suburban					
POLICY A	391	482	374	434	452
POLICY B	732	898	635	828	788
Territory 09 - Prince Georges County Outer Suburban					
POLICY A	415	464	392	460	516
POLICY B	806	856	660	878	904
Territory 10 - Baltimore Outer Suburban					
POLICY A	365	372	362	456	486
POLICY B	713	726	616	866	864
Territory 11 - Montgomery County Suburban					
POLICY A	350	346	380	544	488
POLICY B	639	650	636	1,044	862
Territory 12 - Prince Georges County Suburban					
POLICY A	450	434	469	544	516
POLICY B	771	778	792	1,044	904
Territory 13 - Eastern Counties					
POLICY A	318	318	302	294	370
POLICY B	594	594	510	552	642
Territory 14 - Western Counties					
POLICY A	296	296	296	326	324
POLICY B	540	540	499	620	564
Territory 80 - Central Western					
POLICY A	296	336	NA	NA	NA
POLICY B	576	624	NA	NA	NA

* indicates date of last rate increase

Policy A = 1 Auto
Policy B = 2 Autos

The primary benefits to consumers from bank insurance competition are reduced insurance cost, greater convenience, better information, fairer treatment and more choices. Consumers are increasingly price- and value- conscious, and are concerned over the rising costs and availability of insurance coverage. A major reason for increases in premiums is the costly, inefficient insurance distribution system, where an average of 25 cents of every dollar in premiums is paid in commissions to agents or brokers and overhead costs. Banks could reduce insurance costs to consumers by at least 10 cents of every dollar by reducing intermediaries and by using more cost effective methods of distributing insurance.

Convenience is an important factor in the consumer's decision to select a financial institution. Banks can provide consumers with one-stop financial shopping convenience through bank branches and offices in both large and small communities. Here consumers could carry on their normal banking activities, compare insurance products and perform other financial transactions.

Consumers are often confused by the complexity and the terminology of existing insurance contracts and sales practices. If banks are permitted to offer insurance, there will be a competitive incentive by both insurers and banks to provide clear and complete disclosure of prices, coverages and other contract conditions. Such disclosure will enable consumers to shop for the best insurance rates, coverage and services.

No Tying Arrangements

Opponents of bank competition argue that banks will explicitly or implicitly require borrowers to obtain insurance as a condition for obtaining credit. Similarly, the insurance industry has been accused of tying practices that condition insurance coverage for one policy on the purchase of another. In fact, since there will be more competition between suppliers, even implicit coercion will cause consumers to seek alternative sources of credit and insurance.

The more competitors there are, the less chance that any single provider has the power to coerce or compel consumers into purchasing insurance from that source. Therefore, entry into insurance by depository institutions will provide another level of consumer protection against unfair or coercive practices.

The U.S. Justice Department's Antitrust Division reviewed this issue in commenting on an FDIC proposal to expand bank powers into insurance activities. Their comments in November of 1983 read in part:

> "Participation by banking organizations in a broader range of financial activities would be unlikely to result in a significant increase in anticompetitive tying arrangements. The offering of two services or products as a package may represent an economically efficient means of conducting business. Absent market power, a firm cannot restrain competition by such a practice. Given the usual diversity of choices available to the financial services customer, it is generally

> unlikely that a particular provider of such services possesses the requisite market power to effect an anticompetitive tie. In any event, existing antitrust laws provide adequate protection against anticompetitive ties, whether undertaken by a banking organization, another type of supplier of financial services, or any other type of firm."

Clear and explicit disclosure of alternative sources of insurance and a reasonable period of time (e.g., 30 days) to cancel insurance, protects consumers from coercion by enabling them to shop for the best rates, coverage and service. Finally, consumers are protected against coercion by law. Laws prohibit tying arrangements imposed by state or federally chartered banks, thrifts, bank holding companies and their subsidiaries.

Allowing banks to offer insurance will substantially increase the number of insurance providers and products available to consumers. Banks are well aware that consumers want the best yield on their savings and the most favorable loan rates. Similarly, consumers are demanding more valuable insurance products to meet their changing needs. As competition for the insurance dollar increases, both banks and insurers will develop new insurance products to meet these demands.

In sum, the result of allowing banks to become insurance providers would be a better informed consumer, supplied with a wider choice of products at lower cost.

State vs. Federal Regulation

Under the McCarran-Ferguson Act of 1945, Congress granted the states authority over the permissible insurance activities of state-chartered institutions. In addition, the dual banking system authorizes the states to regulate state-chartered banks. A number of states have authorized state-chartered banks to offer insurance to the public. Table 4 lists 16 states that permit agency or brokerage powers, (including 4 states that also permit underwriting) and 6 states that are silent on bank insurance powers. In addition, other states are considering legislation to permit banks to offer insurance.

The insurance industry is strongly opposed to federal regulation of insurance, yet it continues to urge Congress to preempt state authority over insurance activities of state-chartered banks. Consequently, legislation has been introduced in both the Senate and House that would restrict the insurance activities of bank holding company subsidiaries and affiliates beyond those already proscribed under Title VI of the Garn-St Germain Act, and would limit the activities of state-chartered banks outside the home state to those authorized for national banks under Section 4(c)(8) of the Bank Holding Company Act. The Garn-St Germain Act did _not_ preempt the right of individual states to regulate insurance. It did, however, provide a number of exceptions to the prohibitions on insurance activities of bank holding company subsidiaries.

Table 4

Authorized Insurance Activities of State Chartered Banks

State	Underwriting	Agency or Brokerage	Silent
Alabama	X	X	
Alaska			X
Arizona			X
Delaware	X*	X	
Indiana		X	
Iowa		X	
Maryland		X	
Minnesota		X	
Mississippi		X	
Missouri		X	
Montana		X	
Nebraska		X	
No. Carolina	X	X	
No. Dakota			X
Oklahoma			X
Oregon		X	
Rhode Island		X	
So. Carolina			X
So. Dakota	X	X	
West Virginia			X
Wisconsin		X	
Wyoming		X	

* Only for 3 grandfathered institutions.

These exceptions include the ability of banks to engage in insurance agency activities in locations with populations not exceeding 5,000 inhabitants and additionally, to engage in such activities in any location having inadequate insurance facilities. The exceptions in Title VI further support the view that Congress did not intend to prohibit all affiliations between banks and insurance companies or to establish a policy against all such affiliations, because Title VI permits the continuation of all insurance activities previously approved under subsection 4(c)(8) prior to May 1, 1982, and also permits all bank holding companies with assets of $50 million or less to engage *de novo* in insurance agency activities. Title VI does not eliminate or restrict existing affiliations between banks and insurance companies.

The insurance industry would prefer to see all these exceptions eliminated to prevent competition from banks and to impede marketplace responses to consumer demands. It would go further and preempt state authority to regulate the insurance activities of state-chartered banks, while upholding state regulation of insurance. It is important to note that the situation in South Dakota does not call for such an extreme and illogical solution.

We believe Congress should *not* cripple the ability of the states to regulate the insurance activities of state-chartered financial institutions. Restrictive federal legislation would place banks at a further competitive disadvantage vis-a-vis insurance companies, retailers, and other non-bank financial institutions.

Furthermore, such legislation is not in the best interest of consumers, since it denies them the opportunity to obtain insurance at a lower cost, and more conveniently.

Existing state regulatory authorities can adequately protect the public interest and ensure the safety and soundness of financial institutions. Regulation of insurance practices of banks and bank holding company subsidiaries can be handled by each state's insurance department and banking activities of insurance companies can be regulated by the appropriate banking regulator. Regulators already have the means to deal with bank/insurer affiliations, and have the necessary licensing and examination powers to handle actual or potential problems.

Most states have adopted the National Association of Insurance Commissioners' Model Unfair Trade Practices Act which prohibits unfair methods of competition, and unfair or deceptive acts or trade practices. Banking institutions engaged in insurance would be subject to this law just as insurers are today.

Thus, the expertise of the regulators will continue to be utilized and the safeguards developed over the years will remain in place. The public will remain protected against unconscionable practices and the safety and soundness of all financial institutions will be maintained.

Conclusion

The rationale for broader insurance powers for banks and bank holding companies is overwhelming, while the rationale for restrictive legislation is weak, anti-competitive and not in the interests of the consumer. The marketplace continues to shape and direct the financial services industry. Changing consumer demands and lifestyles, increased competition for consumers' funds, and the economics and technology of distribution systems reflect some of the driving forces of the market. Attempts by protectionists to hold these forces in check will ultimately fail, whether at the state or federal level.

Open competition in the insurance and banking industries will primarily benefit consumers, who will be able to reduce their premium costs, increase convenience, obtain better information and fairer treatment, and have access to a wider range of choices among insurance products and providers. There will also be significant benefits to insurance companies which can reduce their distribution costs, access a broader customer base and increase marketing productivity.

It is time for the insurance and banking industries to take a broader view of the emerging financial services industry. Rather than resisting change and competition, we should be planning and developing the best products and services to meet the demands of the marketplace.

Chairman ST GERMAIN. Thank you, Mr. Rauscher.

Now we will hear from B.F. Backlund, president, Independent Bankers Association of America.

Mr. Backlund.

STATEMENT OF B.F. BACKLUND, PRESIDENT, INDEPENDENT BANKERS ASSOCIATION OF AMERICA [IBBA]

Mr. BACKLUND. Mr. Chairman and members of the committee, my name is B.F. (Chip) Backlund, president of the Bartonville Bank near Peoria, IL. I am also president of the Independent Bankers Association of America. I appreciate this opportunity to present the IBAA's views on the South Dakota loophole issue.

Mr. Chairman, we support legislation that would close the South Dakota loophole, as you defined it in your letter of invitation to this hearing. That letter asked for our views on State laws that grant State-chartered banks powers beyond those granted under Federal law and which may be exercised only in other States. Our convention resolution made clear that: "The IBAA does not believe that any State should be permitted to export such activities outside its borders* * *."

Recently, the Federal Reserve denied Citicorp's application to take advantage of the loophole, indicating that it will block similar proposals.

Does that mean Congress need not act in this area? No, it does not. Unless the loophole is closed by statute, the Fed's decision could be successfully challenged and other States might be tempted to pass laws exporting new powers.

In our view such legislation should simply prohibit the export of these State-authorized services. It should not go beyond that simple goal and compromise important State authorities.

States should retain their traditional role in the country's financial system. As our convention resolution said: "The dual banking system performs a valuable function by permitting States to be intrastate laboratories for change in banking-related products and services."

Unfortunately, the legislation that has been proposed to date on this issue has gone far beyond what is necessary to close the South Dakota loophole. For example, last year's nonbank bank loophole-closing bill, H.R. 5916, had three features that we oppose. These are discussed in my written testimony, so I will just emphasize the one that is the most troublesome.

The bill would have limited the insurance activities of bank holding company affiliates and subsidiaries, including State-chartered banks, even if the activity is conducted only within an institution's home state. This would have created a precedent of Federal limitation on State-chartered banks that would have undermined the value of the dual banking system.

Obviously, the insurance industry has used the controversy over South Dakota's controversial statute to seek a victory at the Federal level in battles that it fears it may lose in State legislatures. For an industry that has fought Federal regulation at every turn, that is a remarkable stance.

If Congress wants to close the South Dakota loophole, then it should do so. But it should not use that legislation as an excuse to undermine the dual banking system and the ability of States to conduct reasonable experimentation within their borders. Many States have for years authorized their banks to offer services beyond those permitted under Federal law. These operations should not be arbitrarily closed down without any evidence that they are harmful or discriminatory.

We hope that any legislation will be confined to the problem at hand, not be used as a bootstrap to make major changes in the financial system without full debate.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Backlund on behalf of the Independent Bankers Association of America follows:]

TESTIMONY OF

B. F. (Chip) Backlund

President
BARTONVILLE BANK, PEORIA, ILLINOIS
AND
PRESIDENT

Independent Bankers Association of America
Washington, DC

Before the

HOUSE COMMITTEE ON BANKING, FINANCE
AND URBAN AFFAIRS

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
AND
REGULATION AND INSURANCE

Concerning

THE "SOUTH DAKOTA" ISSUE

September 11, 1985

Mr. Chairman and Members of the Committee, my name is B. F. (Chip) Backlund, President of the Bartonville Bank near Peoria, Illinois. I am also President of the Independent Bankers Association of America. IBAA is the national trade association of community banks, representing some 7,400 small and medium-sized banks throughout the United States.

I appreciate this opportunity to present the IBAA's views on the South Dakota loophole issue.

Mr. Chairman, we support legislation that would close the South Dakota loophole--as you defined it in your letter of invitation to this hearing. That letter asked for our views on state laws that grant state-chartered banks powers beyond those granted under federal law and which may be exercised only in other states. Our convention resolution made clear that: "(T)he IBAA does not believe that any state should be permitted to export such activities outside its borders ...."

The recent decision by the Federal Reserve board denying Citicorp's attempt to purchase a bank in South Dakota has taken much of the urgency out of the situation. In that case Citicorp wanted to buy a state-chartered bank in South Dakota to engage in a wide range of insurance activities outside the state. The

Federal Reserve said it denied the application because it viewed it as an attempt to evade the intent of the Bank Holding Company Act.

The Fed's strong stance may be partially explained by a recent court decision involving the Douglas Amendment to the Bank Holding Company Act. In that case U.S. Trust--a New York bank holding company--had gotten Fed approval to take deposits at its Florida subsidiary under the nonbank bank loophole. The U.S. Court of Appeals found that U.S. Trust was attempting to evade the interstate deposit-taking limitations of the Bank Holding Company Act, and decided that the Fed should have used its authority to prevent evasions of the Bank Holding Company Act and blocked U.S. Trust. Given this judicial revival of the Federal Reserve's power to prevent evasions of the Act, the Fed may well use its reasoning in the Citicorp case to block any other proposals to take advantage of the South Dakota loophole.

Does that mean Congress need not act in this area? No, it does not. Unless the loophole is closed by statute, the Fed's decision could be succesfully challenged, and other states might be tempted to pass laws exporting new powers. Therefore, it would be prudent for Congress to clarify the situation.

In our view, such legislation should simply prohibit the export of these state authorized services. We wish to emphasize that legislation closing the loophole should not go beyond that simple goal and compromise important state authorities. Our Association, along with five other bank trade groups, recently wrote to Chairman Garn saying that:

> (W)e believe any provision should be drafted narrowly so as to retain maximum authority to the states. This could be done simply by prohibiting state-chartered banks from exporting insurance products not permissible for bank holding companies...."

The key point here is that states should retain their traditional role in the country's financial system. As our convention resolution said:

> The dual banking system performs a valuable function by permitting states to be intrastate laboratories for change in banking-related products and services.

Unfortunately, the legislation that has been proposed to date on this issue has gone far beyond what is necessary to close the South Dakota loophole. The most drastic example is last year's nonbank bank loophole-closing bill (H.R. 5916) which had three features that we believe are unnecessary:

First, the bill limited the activities of all state-chartered banks, not just those within a holding company.

Second, it limited these activities to the banks' home-state residents only.

Third, it limited all insurance activities, not just those prohibited within the state but exported beyond its borders.

The House Committee report stated that H.R. 5916 was intended to address the problem of states that "have attempted to authorize broad powers for their state-chartered depositories, making them attractive targets for takeover by firms that wish to exercise these broad powers across state lines." However, the bill covered all state chartered banks, whether or not they were within a holding company. Of course, any bank that is the target of a successful takeover will, by definition, become part of a holding company. Therefore, legislation need only cover banks within a holding company.

In addition, the legislation limited services to state residents. That would have put the onus on the bank to determine whether the person seeking the service was truly a resident or not. This would be particularly troublesome near borders where people cross from one state to another on a daily basis. Frankly, not even the current limitations on interstate deposit taking are this strict.

Finally -- and this is a matter of greatest concern -- the bill included language, sought avidly by the insurance industry, which would limit the insurance activities of bank holding company affiliates and subsidiaries, including state chartered banks, wherever that activity is conducted. This would have created a precedent of federal limitation on state chartered banks that undermined the value of the dual banking system.

Obviously, the insurance industry has used the controversy over South Dakota's controversial statute to seek a victory at the federal level in battles that it fears it may lose in state legislatures. For an industry that has fought federal regulation at every turn, that is a remarkable stance.

If Congress wants to close the South Dakota loophole, then it should do so. But it should not use that legislation as an excuse to undermine the dual banking system and the ability of states to conduct reasonable experimentation within their borders. Many states have for years authorized their banks to offer services beyond those permitted under federal law. These operations should not be arbitrarily closed down without any evidence that they are harmful or discriminatory.

We hope that any legislation will be confined to the problem at hand, not be used as a bootstrap to make major changes in the financial system without full debate.

Chairman ST GERMAIN. Now we will hear from Robert R. Googins, executive vice president, American Council of Life Insurance.

STATEMENT OF ROBERT R. GOOGINS, EXECUTIVE VICE PRESIDENT, CONNECTICUT MUTUAL LIFE INSURANCE CO., REPRESENTING THE AMERICAN COUNCIL OF LIFE INSURANCE

Mr. GOOGINS. Thank you very much, Mr. Chairman.

I think it is nice to be here again, but if you will permit me to reserve final decision until the conclusion of your questioning, in light of past experience I will reserve final decision until that time.

I think it would be remiss of me if I did not point out that some of you may possibly draw some wrong conclusions from Congressman McKinney's remarks about the fact that no one from the insurance industry lives in his district. Of course that is true, but it is because we cannot afford to live in his district. I would like to set the record straight on that.

I should say for Mr. Ryan's benefit that some of my finest friends are from the American Bankers Association. I wish well to everybody here.

I am, indeed, pleased to represent the American Council of Life Insurance with respect to the so-called South Dakota State-enabling legislation loophole.

Mr. Chairman and members of the subcommittee, the South Dakota issue in our view is a very simple one. Should bank holding companies be permitted to use State bank subsidiaries to engage in activities which are otherwise clearly and expressly prohibited to them under the Bank Holding Company Act? We believe that the answer to that question is an emphatic no and that any other answer in effect permits the States to repeal at will any or all of section 4 of the Bank Holding Company Act which was intended by Congress to limit the risks to which bank holding companies are exposed.

This is particularly true when the motives of an enacting State are likely to be unrelated to issues of banking policy as Governor Partee noted in his testimony.

Whenever the subject of South Dakota comes up, loophole advocates always talk about the dual banking system and the rights of the States.

One thing that has neatly been obscured in all of this is that dual in the dual banking system means that a substantial Federal role is contemplated. That Federal role, at least in terms of the regulation of bank holding companies, would be dramatically reduced and potentially eliminated should the South Dakota loophole be validated on a de facto basis by congressional inaction.

In our view it is imperative, therefore, in response, Mr. McCollum, to the questions you asked of Governor Partee, that Congress act quickly and decisively to close the South Dakota loophole and, in so doing, discourage the use of State enabling legislation as a means of evading Federal law which is something that was predicted by Governor Partee in the event that action is not taken.

The recent Federal Reserve Board action to deny Citicorp's application to acquire a South Dakota bank was in our opinion both correct and unavoidable, but it should not be viewed as a substitute for further congressional action. As noted in my written statement, the Fed's decision was narrowly drawn and did not reach the precise issue of whether Bank Holding Company Act restrictions apply to subsidiary banks, as they should.

In addition, it is not certain that the Fed would respond in the same fashion if the intended revision of the act was not as blatant as was apparent in the application before it. Therefore, we disagree with those members of the panel who would say that the issue is mooted by that particular decision.

This issue can be effectively clarified by making section 4(c)(8) of the Bank Holding Company Act expressly applicable to all parts of the bank holding company. Such language was adopted by this committee last year in section 2(b) of H.R. 5916 and by the Senate in S. 2851.

I should emphasize that this language in no way limits the ability of States to govern their free-standing resident banking institutions. It does require, however, that banks which elected to form federally regulated bank holding companies by accepting all the benefits that Federal statute bestows on them must conform to the underlying national banking policy. I should also point out that the act contains significant exemptions from the insurance restrictions which may be utilized by all but the larger bank holding companies, it seems to me.

As a final comment I should note that the subcommittee and its parent committee have already approved legislation to close the nonbank bank loophole, the principal avenue by which some insurers and other commercial entities have sought to acquire banking capabilities. Competitive equity for those in the financial services marketplace would seem to argue, therefore, for additional action as we have suggested to keep bank holding companies from entering the business of insurance.

Despite the actions taken by some members of the insurance community, we continue to believe that maintaining the historic separation between banking and commerce is the most reliable way to avoid undue concentrations of economic power, conflicts of interest, self-dealing, the use of credit leverage and other threats to consumer interests and the safety and soundness of the banking system. We do realize that we cannot have it both ways.

Furthermore, comments that have been made with respect to the applicability of States' rights and the McCarren Act and traditional regulation by the States of insurance companies are irrelevant to this particular issue.

In short, Mr. Chairman, title VI of the 1982 Act was worth enacting in the first place, and we believe, therefore, if it was worth enacting in the first place, then it is worth taking the time to amend it in such a way as to prevent its circumvention.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Googins representing the American Council of Life Insurance follows:]

STATEMENT OF THE
AMERICAN COUNCIL OF LIFE INSURANCE

Before the

SUBCOMMITTEE

on

FINANCIAL INSTITUTIONS SUPERVISION, REGULATION AND INSURANCE

of the

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

on

The "South Dakota" Loophole

September 11, 1985

Statement Made by:

Robert R. Googins
Executive Vice President
Connecticut Mutual Life
Insurance Company

Mr. Chairman, members of the Subcommittee, my name is Robert Googins and I am the Executive Vice President of Connecticut Mutual Life Insurance Company. I am appearing today on behalf of the American Council of Life Insurance whose 627 member companies have approximately 95% of the life insurance in force in the United States and 96% of the insured domestic pension business.

I am pleased to be able to offer the views of the life insurance industry on the so-called "South Dakota loophole." We believe the loophole must be closed to prevent the circumvention of activities restrictions in the Bank Holding Company Act, to ensure equity in the financial services marketplace and to preserve the ability of Congress to establish and maintain national banking policy.

Mr. Chairman, our basic policy position opposing the combination of banking with other forms of commerce has been presented many times before your Subcommittee. For this reason, our statement today will not deal extensively with the rationale supporting this position, namely, fundamental considerations of safety and soundness, competitive equity and regulatory conflicts. Rather, our focus will be on the exploitation of state enabling legislation as a potential means of circumventing existing provisions of federal banking law and, in turn, the explicit intent of Congress.

South Dakota Loophole

In March of 1983 the South Dakota legislature passed a law granting state banks dramatically expanded insurance powers and permitting the acquisition of state banks by out of state bank holding companies. The genesis of this law had nothing to do with a desire on the part of lawmakers in South Dakota to expand the range of permissible powers for their depository institutions. Rather, it was a direct result of Congress' passage in October 1982 of the Garn-St Germain Depository Institutions Act. Title VI of that Act codified restrictions on the insurance authority of bank holding companies which, for the most part, had previously been contained in Regulation Y as administered by the Federal Reserve Board.

In Title VI of Garn-St Germain, Congress amended Section 4(c)(8) of the Bank Holding Company Act (BHCA) to provide that most insurance activities may not be lawfully conducted by bank holding companies. In so doing, Congress reiterated its intent that the separation between banking and insurance should be preserved.

Facing the formidable barrier of Section 4 of the BHCA at the federal level, the bank lobby quickly turned to the states in an effort to circumvent the new insurance restrictions. Bankers believed that if they could persuade a state legislature to invest domestically chartered depository institutions with largely unlimited insurance powers (or, for that matter, any other nonbanking power currently prohibited to bank holding companies) there might be a way for bank holding company systems to avoid Section 4 through the acquisition of a state bank. 1/

Two arguments have been advanced in support of the proposition that a bank holding company can utilize a state chartered bank to engage in activities that would otherwise be prohibited to it. First, there is the rather transparent assertion that in the context of an acquisition application filed under Section 3 of the BHCA, the Fed is precluded from even considering the insurance limitations contained in Section 4 of that Act. The merits of this assertion were never clear to anyone save a handful of bank lawyers, and the viability of this argument was, as discussed below, flatly rejected in the recent decision of the Federal Reserve Board denying Citicorp's bid to acquire a South Dakota bank.

1/ The South Dakota law also has a provision which has the effect of permitting the exercise of expanded insurance powers by banks only outside the state of South Dakota. This "export only" provision has been referred to by some as "the South Dakota loophole". While this provision may represent poor public policy and may violate the Commerce clause of the U.S. Constitution, it is not in any real sense a "loophole". The "South Dakota loophole" referred to in our testimony and described more fully in this statement has to do with the attempted use of state enabling legislation by bank holding companies to circumvent federal law.

The second argument suggests that the insurance limitations contained in Section 4(c)(8) of the BHCA extend exclusively to bank holding companies and their direct nonbank subsidiaries. It is argued that the Section 4(c)(8) limitations do not extend to a bank subsidiary of a bank holding company or to any of the downstream operations of such a bank. This rationale is the essence of what is generally referred to as the South Dakota loophole. Of course, the obvious effect of legitimizing such a loophole would be to permit bank holding company systems, simply by the addition of a state bank subsidiary, to conduct virtually any activity permitted by the bank's domiciliary state notwithstanding the existence of federal laws explicitly prohibiting such activities to bank holding companies themselves.

These issues were joined when, shortly after South Dakota's 1983 law was enacted, three large bank holding companies (Citicorp, BankAmerica Corp. and First Interstate Bancorp) filed applications with the Fed to acquire South Dakota banks. Although the initial applications made little, if any, mention of conducting insurance activities, persistent questioning by the Fed ultimately produced representations that indeed the bank holding companies intended to use their South Dakota banks as a base for engaging in heretofore prohibited aspects of insurance underwriting and agency activity.

By February of this year, Citicorp was the sole applicant still in pursuit of a South Dakota bank. On August 1, the Fed issued a unanimous opinion (attached to this Statement as Appendix A) denying the Citicorp application. The Board concluded that the intended use of a South Dakota bank as a means of enabling the bank holding company to enter the insurance business constituted "... an evasion of Section 4 of the Bank Holding Company Act, ..." In rendering this decision, the Fed flatly rejected the first argument noted above, to wit, that a Section 3 application does not involve Fed consideration of Section 4 constraints.

As the Fed reviewed the Citicorp application, it concluded that "the primary, if not sole, purpose" of the proposed acquisition was to circumvent the BHCA. Having reached this determination, the Fed found ample authority under Section 5 (b) of the BHCA to deny any application. 2/ This being the case, the Fed found it unnecessary to grapple with the broader question of whether the insurance limitations contained in Section 4(c)(8) apply to state banks that are part of a bank holding company system. Explicit in the Fed's decision, however, was the agency's exercise of at least some degree of authority over state banks that are held in holding company form.

2/ Section 5(b) of the BHCA provides that "The Board is authorized to issue such regulations and orders as may be necessary to enable it to administer and carry out the purposes of this Act and prevent evasions thereof."

The insurance industry has long argued that the South Dakota loophole was illusory and that the plain language of the BHCA, particularly when read in light of the legislative history of Title VI of Garn-St Germain, precluded this type of exploitation of state enabling legislation. For this reason, we have consistently characterized our proposed legislative solution to the South Dakota situation as nothing more than a clarification of existing law. In this regard, the Fed decision is significant, for it bears out the view that present law does not in fact recognize the loophole, at least in the context of an application such as that advanced by Citicorp. 3/

We wish to stress, however, that the Fed's decision should not be construed as a substitute for further Congressional action. As noted above, the Fed did not reach the precise issue of whether the Section 4 restrictions apply to subsidiary state banks. It is not certain that the Fed would respond in the same manner to an application based on a different set of facts, perhaps where it was at least arguable that the transaction taken as a whole did not have as its primary purpose the circumvention of the BHCA.

3/ It is relevant to note that in 1984 the Fed suspended processing the three bank holding company applications for South Dakota banks and, in its press release announcing that action, stated that it "could not approve the proposed bank acquisition in view of present law and expressions of Congressional intent ...."

Beyond the fact that the Fed's decision may not be entirely dispositive of the South Dakota loophole issue, there are several other compelling reasons for Congress to act promptly on this issue. First, it is clear that Congressional inaction will make it increasingly tempting for states to follow the lead of South Dakota and, through their own legislative process, attempt to alter the contours of national banking policy. This, of course, would represent an inconsistent and irrational approach to establishing sound national banking policy and, more importantly, would effectively preempt the traditional role of Congress in this regard.

Second, there are several federal bank regulatory agencies that have apparently concluded that they and not Congress will be the guiding force in deregulating the banking industry. The recent rule proposals advanced by the FDIC regarding the insurance and real estate activities of federally insured banks are illustrative of this phenomenon. We submit that deregulation through regulatory fiat is neither an appropriate exercise of rulemaking authority nor a development that will prove to be in the best long-term interest of financial institutions or the general public. There is no question that a strong signal from Congress would discourage such administrative forays into the realm of deregulation.

Language Approved in 1984

Last year in Section 2(b) of H.R. 5916 the House Banking Committee considered and approved language to clarify that the insurance restrictions which are contained in Section 4(c)(8) of the Bank Holding Company Act (BHCA) apply to all subsidiaries of a bank holding company including those which are state banks.

This language was strongly supported by all members of the insurance community, and would have prevented BHCs from utilizing South Dakota-type statutes to evade the BHCA.

For various reasons H.R. 5916 was not enacted, and thus language addressing the application of BHCA restrictions to subsidiary banks is still needed. We recommend the following language, which is essentially the same as that in Section 2(b) of last year's H.R. 5916:

"Section 4(c)(8) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)) is amended by inserting between the words 'bank holding company' and 'to provide insurance' the words 'or any subsidiary or affiliate thereof'."

Not a States Rights Issue

Opponents of the 2(b)-type language have tried to obscure the real issue by claiming that the provision infringes on states' rights. This is not a states' rights issue. We are talking about the activities of companies which have opted to become federally regulated entities subject to a federal statute, the Bank Holding Company Act. This Act contains explicit restrictions on the extent to which these entities and their subsidiaries or affiliates may engage in insurance activities.

We are not advocating an end to the dual banking system. If the states wish to confer new powers on their resident banking institutions which are not part of a bank holding company system, that is their privilege. If we disagree with a particular proposal affecting free-standing state-chartered banks, we will challenge that proposal in the state legislature. But state-chartered institutions which elect to form federally regulated bank holding companies are clearly overreaching when they argue that they should be viewed the same as free-standing state banks.

In addition to operational considerations, there are three significant advantages that inure to a bank held in holding company form. The first relates to the substantial tax advantages they enjoy over free-standing banks in the financing of stock purchase transactions, in effect, the ability to use before-tax instead of after-tax dollars to purchase shares of bank stock.

The second advantage relates to the avoidance of restrictions imposed by state law on branching. For example, some states, pursuant to their regulatory objectives, prohibit the establishment of branch banks. In most of those states an individual bank can nonetheless expand its locations within the state by forming a parent BHC under federal law and then using the BHC to acquire additional banks. In these instances BHCs are formed, at least in part, to permit the avoidance of state law.

The third advantage is in the same vein. By forming bank holding companies, state banks can often avoid state restrictions on certain interstate operations.

Now these same BHC's would contend that they do not have to observe BHCA restrictions because their subsidiary banks are creatures of state law. Unfortunately, they simply cannot have it both ways. If they are intent on utilizing the advantageous provisions of the BHCA, they must also submit to its constraints, which have as their underlying purpose the maintenance of safety and soundness.

Several other important points need to be made about the 2(b)-type language. First, it would have absolutely no effect on free-standing state-chartered banks. Thus, state-chartered banks not affiliated with a BHC could continue to engage in whatever insurance activities their state legislatures permit. Second, the language leaves unchanged all the exemptions from the insurance restrictions contained in the BHCA. 4/ Hence, absolutely no restrictions on insurance agency activity would apply to more than 80% of all BHCs (those with less than $50 million in assets or principally located in small communities) and their subsidiary state banks. Only the largest BHCs would be subject to these restrictions.

Opponents of the 2(b)-type language are intimating that this is an instance of the insurance industry trying to disenfranchise some defenseless little state banks who are only trying to do what their legislatures permit and who happen, incidentally, to be part of a holding company. The truth is that if smaller BHCs want to operate an insurance agency through their state bank subsidiaries, they can. The main restrictions relate to under-

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4/ Permitted under the exemptions are unlimited insurance agency operations for bank holding companies with less than $50 million in assets or which are principally located 1) in communities of 5,000 or less population or 2) where other insurance facilities are inadequate. Also exempted are insurance agencies which were in operation or approved before May 1, 1982, regardless of holding company size.

Significantly, the only insurance underwriting activity exempted relates to credit insurance. The purpose of credit insurance is to guarantee repayment of a loan to the financial institution itself in the event of the death or disability of the borrower. Because the bank or other lender is the named beneficiary, the underwriting and sale of credit insurance can serve to reduce the risks to which the institution is subject.

On the other hand, other types of insurance underwriting, for which the bank would not be the beneficiary, result in the creation of contingent liabilities and serve to increase the risks to which the institution is subject.

writing, for which, as a practical matter, only the large BHCs are willing or able to make the necessary commitments.

Inability to Separate Functions

In previous appearances before this Subcommittee insurance industry witnesses have testified in great detail on the reasons for keeping banking and commerce separate. Therefore, I do not intend to cover that ground again. The one point that should be made, however, relates to the difficulty of effectively separating banking and nonbanking functions which are carried on within a single business organization.

Regulatory jurisdiction, the ability to segregate liability and the prevention of self-dealing are all significant problems for which there are few satisfactory solutions. Recent events have shown, however, that the problem of public perception may make all the others pale in comparison.

I am referring specifically to the difficulties being experienced by Community Savings & Loan, an otherwise solvent Maryland institution which happened to own a real estate investment subsidiary (EPIC) which collapsed. Despite public announcements that EPIC was legally and financially separate from the S&L, the parent thrift was engulfed in an escalating panic and had to be closed. There was separation to be sure, everywhere except in the minds of depositors, where it really counted.

We have always challenged the notion that there could be effective separation of banking and nonbanking activities, even through the use of a holding company and subsidiary structure. The Federal Reserve Board has often expressed a similar concern, most recently in an August 22 opinion denying a request by a bank holding company to engage in insurance activities in Australia. The Board stated that ". . . holding company ownership does not provide total insulation for the bank from the potential risk of nonbanking activities because problems in any part of the institution will necessarily have some impact on other parts of the consolidated organization." The more we see in the marketplace, the more we are convinced that such concerns cannot be overstated.

Equity Requires Action on South Dakota

This Subcommittee and the parent Committee have already considered and approved legislation to close the nonbank bank loophole, the principal avenue by which commercial entities, including some of the Council's own insurance company members, have sought to acquire a banking capability. That being the case, equity clearly requires that bank holding companies be similarly prevented from exploiting the South Dakota loophole to engage in insurance activities otherwise prohibited to them by Title VI of the St Germain-Garn Act of 1982. Unless the Committee acts on the South Dakota issue as we have proposed, this equity cannot be achieved.

We, therefore, urge your prompt action to clarify the application of the insurance restrictions contained in the Bank Holding Company Act, as outlined above. Thank you.

FEDERAL RESERVE press release

For immediate release August 1, 1985

The Federal Reserve Board today announced its decision denying the application by Citicorp, New York, New York, to acquire American State Bank of Rapid City, Rapid City, South Dakota.

Attached is the Board's Order regarding this matter as well as concurring statements by Governor Rice and Governor Seger.

Attachments

FEDERAL RESERVE SYSTEM

Citicorp
New York, New York

Order Denying the Acquisition of a Bank

Citicorp, New York, New York, a registered bank holding company within the meaning of the Bank Holding Company Act (the "BHC Act") (12 U.S.C. § 1841 _et_ _seq_.), has applied for Board approval under section 3 of the Act to acquire all of the shares of American State Bank of Rapid City ("Bank"), Rapid City, South Dakota. In connection with this application, Citicorp has specifically requested the Board's approval to engage through Bank in underwriting life insurance, accident and health insurance and annuities, and to act as agent or broker for the sale of all lines of insurance on a nationwide basis.

Notice of the application, affording an opportunity for interested persons to submit comments, has been given in accordance with the provisions of the Act. The time for filing comments has expired and the Board has considered the application and all comments received, including the comments submitted by Protestants,[1] in light of the factors specified in the Act.

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[1] Comments in opposition to the proposed transaction and a request for a formal hearing were made on behalf of the American Council of Life Insurance, the American Insurance Association, the National Association of Independent Insurers,

(footnote continued on next page)

South Dakota law specifically provides that an out-of-state bank holding company may acquire a single existing state chartered bank in South Dakota. S.D. Codified Laws Ann. § 51-16-40(b) (1984). South Dakota law also permits all banks chartered under the laws of South Dakota to engage, either directly or through subsidiaries, in all facets of the insurance business. S.D. Codified Laws Ann. § 51-18-30 (1984). Under South Dakota law, however, a South Dakota bank acquired by an out-of-state bank holding company is prohibited from expanding or acquiring new banking offices or remote service units by merger, acquisition or de novo and is required to conduct its insurance activities in South Dakota in a manner and at a location that is not likely to attract customers from the general public in South Dakota to the substantial detriment of existing insurance companies, brokers and agents in the state. S.D. Codified Laws Ann. § 51-16-41 (1984). In addition, a de novo South Dakota bank acquired by an out-of-state bank holding company is limited to operating a single banking office in South Dakota and is required to conduct its banking business in South Dakota at a location and

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1/ (footnote continued)

and the Alliance of American Insurers. The Board also received comments urging denial of this application from the National Association of Insurance Commissioners; from the Mortgage Insurance Companies of America; and from the Independent Insurance Agents of America, the National Association of Casualty and Surety Agents, the National Association of Surety Bond Producers, the National Association of Professional Insurance Agents, and the National Association of Life Underwriters.

in a manner so that it is not likely to attract customers from the general public in South Dakota to the substantial detriment of existing banks in the state. Id. South Dakota banks owned by South Dakota bank holding companies are not subject to the same limitations or restrictions as apply to state banks owned by out-of-state bank holding companies, and may, for example, establish branches statewide.

This application was originally submitted to the Board in June 1983, and included a proposal by Citicorp that contemplated engaging in insurance activities without limitation. On January 6, 1984, the Board suspended processing of the application at the request of Citicorp, noting that the application raised significant legal questions concerning the applicability of the Bank Holding Company Act to state chartered holding company banks and their nonbank subsidiaries, as well as concerning the compatibility of the proposed insurance activities with the provisions of the Act prohibiting bank holding companies from engaging in certain insurance activities. The Board expressed its "tentative judgment that it could not approve the proposed bank acquisitions in view of present law and expressions of Congressional intent, subject to any further consideration by the Congress."

Citicorp requested that the Board reactivate processing of its application on February 20, 1985. Citicorp proposes to conduct a wide variety of insurance activities through Bank, including underwriting general life and other types of insurance and acting as agent or broker for all types of insurance unrelated to extensions of credit. While Citicorp states that it has not yet determined the full range of insurance activities that it will conduct through Bank and has further stated that it will not underwrite property and casualty insurance without prior Board approval, Citicorp has stated that it expects to conduct insurance activities through Bank "to the fullest extent possible."[2] Citicorp expects to conduct these general insurance activities throughout the United States.

While this application has been filed under section 3 of the Act (governing the acquisition of banks), the Board does not believe that approval of such an application would be warranted where the proposal would result in a violation or evasion of the nonbanking provisions of section 4 of the Act.[3] Section 4 of the Act prohibits a bank holding company from engaging in any activity other than banking or managing or controlling banks and activities determined by the Board to be closely related to banking and a proper incident thereto under section 4(c)(8) of the Act. In addition, section 4 of the Act prohibits a bank holding company from acquiring or retaining direct or indirect ownership or control of voting shares of any company that is not a bank, unless the company engages in an activity closely related to banking (or is otherwise exempt under the Act). In 1982, Congress, in Title VI of the Garn-St Germain Depository Institutions Deregulation Act of 1982, amended section 4(c)(8) of the Act to provide specifically that insurance activities, with certain exceptions not relevant here, are not closely related to banking, thereby precluding the Board from authorizing bank holding companies to conduct these activities.

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[2] Citicorp has indicated that it wishes to conduct insurance activities through separately incorporated nonbank subsidiaries of Bank. If the Board concludes that the Act prohibits the conduct of the activity through nonbank subsidiaries of Bank, however, Citicorp has stated it will conduct the insurance activities through separate divisions of Bank.

[3] The Board is authorized under section 5(b) of the Act, indeed in certain circumstances required, to deny proposals that represent a clear evasion of the purposes of the Act, even if the proposal technically conforms to the terms of the Act. *See* *Florida Department of Banking v. Board of Governors*, 760 F.2d 1135 (11th Cir. 1985); *Wilshire Oil Co. v. Board of Governors*, 668 F.2d 732 (3rd Cir. 1981), *cert. denied* 457 U.S. 1132 (1982). The U.S. Supreme Court has recognized the authority of the Board to impose restrictions on holding company banks to prevent evasion of the nonbanking provisions of the Act. *See* *Board of Governors v. Investment Company Institute*, 450 U.S. 46, 60 n.25 (1981).

The Board believes that the record in this case demonstrates that the primary, if not sole, purpose of the proposed acquisition is to permit Citicorp to engage through Bank in various insurance activities that are impermissible for bank holding companies under section 4 of the Act. The Board has considered that the South Dakota statute itself has the effect of enabling out-of-state bank holding companies to evade the nonbanking insurance provisions of the Act. The South Dakota statute allows out-of-state bank holding companies to acquire South Dakota banks, but simultaneously sharply limits the ability of any state bank acquired by an out-of-state bank holding company to conduct a banking business in South Dakota by prohibiting these out-of-state owned banks from expanding their banking offices in any way.

In furtherance of the State's objective of permitting out-of-state holding companies to engage in the insurance business outside South Dakota while restricting banking activities within that State, the South Dakota statute places an even more stringent restriction on de novo banks acquired by out-of-state bank holding companies. The statute limits their banking business to a single office and requires that banking activities be conducted at a location and in a manner that is "not likely to attract customers from the general public in the state to the substantial detriment of existing banks in the state." S.D. Codified Laws Ann. § 51-16-41.

While an out-of-state bank holding company is significantly limited in its ability to conduct a banking business in South Dakota once it acquires a South Dakota bank, the out-of-state bank holding company is permitted to use the South Dakota bank franchise to conduct insurance activities nationwide without any limitation (other than that it restrict its insurance activities within South Dakota itself to avoid competing with South Dakota firms). It is this grant of broad insurance powers, which are otherwise prohibited to bank holding companies, that replaces the opportunity to conduct a banking business in South Dakota as the incentive to attract out-of-state bank holding companies to acquire South Dakota banks. This incentive--crucial to the success of the South Dakota statute's aim of attracting out-of-state bank holding companies as a means of increasing tax revenues and jobs in South Dakota--exists only because insurance activities are expressly prohibited for bank holding companies under the BHC Act.

The Preamble to the South Dakota statute explicitly recognizes that the statute is intended to secure employment and revenue for the State by enabling out-of-state bank holding companies to take advantage of "a unique opportunity" afforded by national laws. As demonstrated, this opportunity is the ability to use a South Dakota bank franchise to conduct insurance activities prohibited to bank holding companies. Thus, the effectiveness of the South Dakota statute to achieve its purpose is premised upon its ability to enable bank holding companies to evade the provisions of the BHC Act.

In these circumstances, it is important to note that Bank will serve primarily as an insurance subsidiary of Citicorp and will conduct relatively insignificant banking activities.[4] While Citicorp has not provided any financial projections regarding the insurance or banking activities it will conduct through Bank, Citicorp has stated that it will conduct insurance activities "to the fullest extent possible" and on a nationwide basis. In this regard, Citicorp has committed to the South Dakota Banking Commissioner to devote approximately $2.5 million to a facility in Rapid City and to employ a minimum of 100-125 additional persons for the purpose of conducting insurance or other nonbanking activities. These plans illustrate that Citicorp contemplates devoting significant resources to conducting a broad range of insurance activities through Bank.

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[4] Under the South Dakota statute, Bank and its insurance subsidiaries must be licensed and supervised by the South Dakota Department of Insurance as well as the State insurance departments in each state in which Bank conducts its insurance activities.

The Board believes, based upon the foregoing commitments and Citicorp's stated intention of conducting insurance activities "to the fullest extent possible," that the resources required to conduct an insurance business as proposed by Citicorp are beyond the capacity of the Bank itself (with $17.5 million in total assets and about 28 full time employees as of March 31, 1985) and that in this situation the bank is acting as a proxy for Citicorp. Moreover, it appears that the activities Citicorp will conduct through Bank will be preponderantly insurance activities prohibited under the Act and not banking activities.[5]

While the potential scope and volume of Bank's insurance activities are not limited, the prohibition imposed on Bank's ability to expand into new banking markets or to open new locations to accommodate growth in the Rapid City market clearly indicates that the banking activities of Bank will be insignificant relative to its contemplated nationwide insurance activities. Under the South Dakota statute, Bank would be limited to its two existing offices and one additional approved but not yet open office in the Rapid City market and--unlike other banks in the State--could not open additional branches either de novo or through acquisition or merger.

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[5] The Board would be prepared to entertain an application by Citicorp to acquire Bank that was limited to engaging in banking activities in South Dakota.

The Board also notes that the great preponderance of insurance activities proposed for Bank raises a substantial question whether Citicorp's activities, after consummation of the proposal, will be limited to those permitted to bank holding companies under the terms of section 4 of the Act. Under that section, the activities of bank holding companies are limited to "banking" or "managing and controlling banks" and activities that the Board determines are closely related to banking. The broad range of insurance activities involved in this case are regulated as insurance and have been expressly determined by Congress to be not closely related to banking. On this basis, these activities do not appear to fall within the scope of either "banking" or "closely related to banking" activities permissible for bank holding companies under section 4 of the Act. In this regard, the Board notes that the South Dakota statute itself makes a sharp distinction between "banking" and the "insurance" activities authorized.

In this situation, the Board concludes that the acquisition of Bank is in reality an acquisition for the purposes of permitting Citicorp to engage in insurance activities prohibited for bank holding companies under section 4 of the BHC Act and that Bank is simply a device to accomplish this objective. Accordingly, the Board has determined that the proposal constitutes an evasion of section 4 of the Act and section 225.22(d)(2) of Regulation Y and that Board approval is therefore precluded.[6]

For the foregoing reasons, the Board hereby denies the application.[7]

By order of the Board of Governors,[8] effective August 1, 1985

(signed) William W. Wiles

William W. Wiles
Secretary of the Board

[SEAL]

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[6] In light of this conclusion, the Board finds it unnecessary to make a determination regarding Protestants' contention that the nonbanking and insurance provisions of the Act apply to holding company banks.

The Board has, however, previously determined that the nonbanking provisions of the Act apply to acquisitions by holding company banks of voting shares of a company. 12 C.F.R. 225.101. The Board has adopted a regulatory exemption from this prohibition, found in section 225.22(d)(2) of Regulation Y, for acquisitions by holding company state banks of all of the voting shares of a nonbanking company engaged only in activities that the bank may conduct directly. This exemption was adopted in order to promote competitive equity between holding company banks and independent banks in the absence of evidence of use by bank holding companies of holding company banks to evade the nonbanking provisions of the Act. Because Citicorp proposes to utilize Bank to evade the nonbanking provisions of the Act, the Board concludes that the proposal is not consistent with the regulation.

[7] In view of the Board's determination to deny the application, the Board has not considered Protestants' request for a formal hearing on the application.

[8] Voting for this action: Chairman Volcker and Governors Martin, Partee, Rice, and Seger. Abstaining from this action: Governor Wallich. Absent and not voting: Governor Gramley.

CONCURRING STATEMENT OF GOVERNOR RICE

I concur in the Board's decision that this application represents an attempt to evade the provisions of the Bank Holding Company Act that prohibit bank holding companies from engaging in most insurance activities. In addition, I wish to emphasize that the nonbanking prohibitions of the Act apply to investments made by bank holding companies, even when those investments are made through a subsidiary bank. Moreover, I believe that the terms, structure, legislative history and purpose of the Act make clear that a bank holding company may not avoid the nonbanking restrictions of the Act by conducting these activities through a subsidiary bank.

Section 4 of the Act provides that, with certain exceptions not relevant here, a bank holding company may not acquire or retain direct or indirect ownership or control of any voting shares of any company that is not a bank. Section 4 also prohibits a bank holding company from engaging in any activities other than banking or managing and controlling banks and activities determined by the Board to be closely related to banking. In this regard, in Title VI of the Garn-St Germain Depository Institutions Act of 1982, Congress amended section 4(c)(8) of the Act to specifically provide that most insurance activities are not closely related to banking and therefore are impermissible activities for bank holding companies. In my judgment, these provisions prohibit the type of activities proposed by Citicorp in this application.

As the majority notes, the Board recognized, shortly after enactment of the Act in 1956, that the prohibition against directly or indirectly acquiring shares of a company applied to acquisitions by all subsidiaries of the holding company, including acquisitions by bank subsidiaries of holding companies. The Act itself deems that voting shares of a company that are held by "any subsidiary of a bank holding company" are deemed to be indirectly owned by the holding company. 12 U.S.C. § 1841(g)(1). The term "subsidiary" in the Act does not exclude bank subsidiaries.

In 1971, the Board reaffirmed its view that the Act applied to nonbank subsidiaries of holding company banks, but adopted a limited regulatory exemption for operating subsidiaries of holding company banks. 12 C.F.R. 225.22(d). In enacting this regulatory exemption, the Board expressly noted that it would review the merits of the regulation in light of evidence that the regulation was being used to evade the nonbanking provisions of the Act.

I have also considered the legislative history of the Act, which clearly indicates that Congress intended the Act to establish a comprehensive framework for the regulation and supervision of bank holding companies and their nonbanking activities. I find nothing in the Act or its legislative history indicating that Congress intended that this framework could be avoided by a bank holding company simply using the device of conducting an activity in a direct or indirect subsidiary. The entire structure of the Act, which grants the Board extensive examination and reporting authority over holding company banks, supports this opinion.

Accordingly, for the foregoing reasons, I believe the proposal should be denied.

August 1, 1985

CONCURRING STATEMENT OF GOVERNOR SEGER

This application raises the important question of the extent to which a state bank within a bank holding company system may conduct activities authorized for the bank under state law. While I agree with the Board that denial of this case is appropriate because of the nature of the Citicorp proposal and certain provisions of the South Dakota statute, I wish to emphasize that I do not object to proposals under which a state bank engages in activities authorized by the state for its banks provided those activities may be conducted within the state without restriction. I believe that states should be authorized to delineate the types of activities that banks may engage in within their borders. Indeed, one of the virtues of the dual banking system is that it allows the states to serve as laboratories for the development and expansion of banking services and activities within their boundaries.

In my view, however, the current proposal is not consistent with the dual banking system or with the Bank Holding Company Act because it represents an attempt by a state to use its state banking franchise to facilitate the conduct by out-of-state bank holding companies of nonbanking activities on a nationwide basis, while severely limiting their ability to conduct these same activities, as well as traditional banking activities, within the state. On this basis, I find the Citicorp proposal to be beyond the latitude permitted under the Bank Holding Company Act.

August 1, 1985

Chairman St Germain. Thank you, Mr. Googins.

We will hear from Jack Rattikin, president of American Land Title Association.

STATEMENT OF JACK RATTIKIN, JR., PRESIDENT, AMERICAN LAND TITLE ASSOCIATION [ALTA]

Mr. Rattikin. Mr. Chairman, my name is Jack Rattikin and I am the president of Rattikin Title Co. located in Fort Worth, TX. I am appearing today as president of the American Land Title Association [ALTA]. ALTA is the national trade association of the land title industry and represents in excess of 150,000 individuals employed as title insurance underwriters, title insurance agents and land title abstracters. The function of the land title industry is to guarantee the safe and efficient transfer of and investment in real property by purchasers and sellers, by mortgage lenders and by those who purchase loans in the secondary market.

My message today is straightforward. In determining whether banks through their holding companies should be permitted to engage in a particular activity, it is imperative that Congress take into account the long-term effects of authorizing such an activity. ALTA believes there are persuasive reasons why Congress should determine that insurance activities, in particular title insurance activities, not be authorized for bank holding company affiliates.

Last year, in testifying before the Senate Banking Committee during its deliberations on the financial services deregulation issue, ALTA recommended a brightline distinction between banking and commerce activities for the sake of the continued safety and soundness of the banking system. In the wake of the crisis of confidence in Ohio and Maryland, ALTA reiterates its opposition to any permissive legislation enabling a bank holding company through a subsidiary to engage in new activities, such as insurance, that would compound the supervisory challenges already facing banking regulators. We support legislation such as section 2(b) of last year's H.R. 5916 that would clarify, once and for all, that the insurance restrictions which are contained in section 4(c)(8) of the Bank Holding Company Act apply to all subsidiaries of a bank holding company including those which are State banks.

Members of the committee are well aware of the Federal Reserve Board's recent rejection of an application by Citicorp to acquire a South Dakota bank for purposes of permitting Citicorp to engage thorugh the State-chartered bank in various insurance activities. Section 4 of the Bank Holding Company Act prohibits a bank holding company from engaging in any activity other than banking or managing or controlling banks and activities determined by the Federal Reserve Board to be "closely related to banking." In addition, Congress passed landmark legislation 3 years ago under the leadership of Chairman St Germain and this subcommittee to amend the Bank Holding Company Act to provide specifically that insurance activities are not closely related to banking, thereby precluding the Federal Reserve Board from authorizing bank holding companies to conduct these activities. The recent Federal Reserve Bank rejection of the Citicorp application is a most welcomed and encouraging development. However, the Fed action should not be viewed as a substitute for specific statutory language that restricts banks from engaging in the business of insurance. ALTA supports legislation that would close the so-called South Dakota loophole thus making it crystal clear to the banking community that Congress has made a policy determination—namely, banks and insurance do not mix.

In addition to the reasons expressed by my insurance industry colleagues for continued separation of banking and insurance, I would like to mention certain unique risks and problems that would be created if bank holding companies were permitted to provide affiliated title insurance on their own mortgages.

Apart from the issue of safety and soundness of banks themselves, there is an additional issue of the safety and soundness of the title insurance process that is raised if banks, through their holding company affiliates, are allowed to insure the validity, priority, and enforceability of their own mortgage loans and the titles underlying those loans. In the vast majority of cases, banks will consider entering the title insurance business because of their belief that borrowers in a substantial number of their real estate mortgage transactions can be referred or steered to their captive title companies, thus providing a guaranteed source of business for those companies. This should be contrasted with the present system, whereby an independent and impartial third party determines the state of the title and insures that title for the benefit of the bank, purchasers of mortgage loans in the secondary market and the borrower/buyer. If the system is changed so that these functions are undertaken by an affiliate of a party with a direct interest in the consummation of the transaction, there will be a serious erosion in the confidence that the public and the secondary mortgage market currently have in the integrity of the title insurance process.

Simply put, the ultimate effect on competition and on the consumer if banks or their holding companies are permitted to expand into the title insurance business will be: decreased competition, market foreclosure, the demise of impartial title insurance expertise, conflicts of interest in quality and scope of title insurance, steering of business by banks to captive title company affiliate, reduced competition due to controlled title insurance arrangements that may generate higher prices to the consumer.

ALTA believes that the centerpiece of any comprehensive public policy decision in restructuring the financial marketplace must adhere to the familiar principles of safety and soundness. Legislation must be adopted—soon—that provides the financial community and consumers alike with a list of do's and don't's to clarify the functions of banks and financial service providers.

The events of the last couple of years, the so-called post financial services deregulation period, have brought ALTA to the conclusion that until the full implication of financial services integration are analyzed we believe that the caution signals of bank and savings and loan failures coupled with the recent thrift industry confidence crisis in Ohio and Maryland should be recognized by Congress.

Now is the time for Congress to shore up the public's confidence. Banks do not run on money—they run on confidence. The same reasons Congress passed the Glass-Steagall Act some 50 years ago separating banking from commerce are still operative today.

One-stop shopping, computer technology, bank marketing innovations and, in particular, expanded banking activities must all be secondary to safeguarding the money of depositors.

Mr. Chairman, absent a congressional decision, a national public policy vacuum in financial services continues to grow and it is a vacuum where a lot has begun to happen—a no man's land where those who look only straight ahead can get blind sided.

ALTA believes there are sound arguments as to why existing holding companies should not be removed. Whatever new version of last year's "Financial Institutions Equity Act" (H.R. 5916) is being contemplated by the committee, ALTA strongly supports the inclusion of statutory language that would close the so-called South Dakota loophole.

Thank you.

[The prepared statement of Mr. Rattikin on behalf of the American Land Title Association [ALTA] follows:]

Statement of

Jack Rattikin, Jr.

President

American Land Title Association

before the

Subcommittee

on

Financial Institutions Supervision, Regulation and Insurance

of the

House Committee on Banking, Finance and Urban Affairs

September 11, 1985

Statement of the American Land Title Association
before the
Subcommittee on Financial Institutions, Regulation and Insurance
of the
House Committee on Banking, Finance and Urban Affairs

"South Dakota Loophole" Closing Legislation

September 11, 1985

Mr. Chairman, my name is Jack Rattikin and I am the President of Rattikin Title Company located in Fort Worth, Texas. I am appearing today as President of the American Land Title Association (ALTA). ALTA is the national trade association of the land title industry and represents in excess of 150,000 individuals employed as title insurance underwriters, title insurance agents and land title abstracters. The function of the land title industry is to guarantee the safe and efficient transfer of and investment in real property by purchasers and sellers, by mortgage lenders and by those who purchase loans in the secondary market.

My message today is straightforward. In determining whether banks through their holding companies should be permitted to engage in a particular activity, it is imperative that Congress take into account the long-term effects of authorizing such an activity. ALTA believes there are persuasive reasons why Congress should determine that insurance activities, in particular title insurance activities, not be authorized for bank holding company affiliates.

Last year, in testifying before the Senate Banking Committee during its deliberations on the financial services deregulation issue, ALTA recommended a brightline distinction between banking and commerce activities for the sake of the continued safety and soundness of the banking system. In the wake of the crisis of confidence in Ohio and Maryland, ALTA reiterates its opposition to any permissive legislation enabling a bank holding company through a subsidiary to engage in new activities--such as insurance--that would compound the supervisory challenges already facing banking regulators. We support legislation, such as Section 2(b) of last year's H.R.5916, that would clarify--once and for all--that the insurance restrictions which are contained in Section 4(c)(8) of the Bank Holding Company Act apply to all subsidiaries of a bank holding company including those which are state banks.

Members of the Committee are well aware of the Federal Reserve Board's recent rejection of an application by Citicorp to acquire a South Dakota bank for purposes of permitting Citicorp to engage through the state chartered bank in various insurance activities. Section 4 of the Bank Holding Company Act prohibits a bank holding company from engaging in any activity other than banking or managing or controlling banks and activities determined by the Federal Reserve Board to be "closely related to banking". In addition, Congress passed landmark legislation three years ago under the leadership of Chairman St Germain and this Subcommittee to amend the Bank Holding Company Act to provide specifically that insurance activities are not closely related to banking, thereby precluding the

Federal Reserve Board from authorizing bank holding companies to conduct these activities. The recent Federal Reserve Board rejection of the Citicorp application is a most welcomed and encouraging development. However, the Fed action should not be viewed as a substitute for specific statutory language that restricts banks from engaging in the business of insurance. ALTA supports legislation that would close the so-called "South Dakota loophole" thus making it crystal clear to the banking community that Congress has made a policy determination--namely, banks and insurance don't mix.

In addition to the reasons expressed by my insurance industry colleagues for continued separation of banking and insurance, I would like to mention certain unique risks and problems that would be created if bank holding companies were permitted to provide affiliated title insurance on their own mortgages.

Apart from the issue of safety and soundness of banks themselves, there is an additional issue of the safety and soundness of the title insurance process that is raised if banks, through their holding company affiliates, are allowed to insure the validity, priority and enforceability of their own mortgage loans and the titles underlying those loans. In the vast majority of cases, banks will consider entering the title insurance business because of their belief that borrowers in a substantial number of their real estate mortgage transactions can be referred or steered to their captive title companies, thus providing a guaranteed source of business for those companies. This should be contrasted with the present system, whereby an independent and impartial third party determines the state of the title and insures that title for the benefit of the bank, purchasers of mortgage loans in the secondary market, and the borrower/buyer. If the system is changed so that these functions are undertaken by an affiliate of a party with a direct interest in the consummation of the transaction, there will be a serious erosion in the confidence that the public and the secondary mortgage market currently have in the integrity of the title insurance process.

Simply put, the ultimate effect on competition and on the consumer if banks or their holding companies are permitted to expand into the title insurance business will be :

...decreased competition

...market foreclosure

...the demise of impartial title insurance expertise

...conflicts of interest in quality and scope of title insurance

...steering of business by banks to captive title company affiliate

...reduced competition due to controlled title insurance arrangements that may generate higher prices to the consumer.

ALTA believes that the centerpiece of any comprehensive public policy decision in restructuring the financial marketplace must adhere to the familiar principles of safety and soundness. Legislation must be adopted--soon--that provides the financial community and consumers alike with a list of do's and don't's to clarify the functions of banks and financial service providers.

The events of the last couple of years, the so-called post financial services deregulation period--have brought ALTA to the conclusion that until the full implications of financial services integration are analyzed, we believe that the caution signals of bank and savings and loan failures coupled with the recent thrift industry confidence crisis in Ohio and Maryland should be recognized by Congress.

Now is the time for Congress to shore up the public's confidence. Bank's don't run on money--they run on confidence. The same reasons Congress passed the Glass-Steagal Act some fifty years ago separating banking from commerce are still operative today.

One stop shopping, computer technology, bank marketing innovations and, in particular, expanded banking activities must all be secondary to safeguarding the money of depositors.

CONCLUSION

Mr. Chairman, absent a Congressional decision, a national public policy vacuum in financial services continues to grow and it's a vacuum where a lot has begun to happen--a no man's land where those who look only straight ahead can get blind sided.

ALTA believes there are sound arguments as to why existing holding companies should not be removed. Whatever new version of last year's "Financial Institutions Equity Act" (H.R.5916) is being contemplated by the Committee, ALTA strongly supports the inclusion of statutory language that would close the so-called "South Dakota loophole".

Chairman ST GERMAIN. Now we are going to hear from David L. Ream, chairman, government affairs committee, National Association of Professional Insurance Agents.

STATEMENT OF DAVID L. REAM, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, VICE PRESIDENT, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS [PIA]

Mr. REAM. Thank you and good afternoon, Mr. Chairman.

The Insurance Producers Coalition is delighted that you are holding this hearing and appreciates this opportunity to support an amendment to resolve the so-called South Dakota issue. I am David L. Ream, CIC, CPIA, an independent insurance agent from Cleveland, OH. I am a vice president of the National Association of Professional Insurance Agents [PIA] and chairman of PIA's government affairs committee. I am also speaking on behalf of the Independent Insurance Agents of America, National Association of Casualty and Surety Agents, National Association of Insurance Brokers, National Association of Life Underwriters, and National Association of Surety Bond Producers. With me is our legal counsel, Jonathan B. Sallet. These associations represent most of the producers that sell and service insurance in the United States.

The South Dakota issue arose because of the efforts of a large bank holding company to evade the clear language and intent of title VI of the Garn-St Germain Depository Institutions Act of 1982. Garn-St Germain amended section 4(c)(8) of the Bank Holding Company Act to prohibit insurance activities by banks, subject only to a few limited exceptions.

Citicorp nevertheless has attempted to acquire a South Dakota bank in order to evade the restrictions of Garn-St Germain. It has promoted this alleged loophole by arguing that title VI only applies to nonbanking subsidiaries of a bank holding company. In other words, Citicorp argues that Congress intended to permit banking subsidiaries to sell insurance while simultaneously prohibiting nonbanking subsidiaries from engaging in precisely the same activity. Citicorp's contention is nonsensical.

It is important to recognize that Citicorp's argument does not apply to South Dakota alone. We face not just a South Dakota loophole but a much broader State law loophole that would allow any State to strip away the protections of the act. The critical issue, therefore, is whether the prohibitions of title VI apply to bank holding companies and all of their subsidiaries, bank and nonbank alike, no matter how the holding company is structured or where its subsidiaries are located.

The answer to this question is simple. Title VI applies to the entire holding company system. Were this otherwise, a bank holding company need only find a receptive general assembly, have a favorable law enacted and use its State-chartered bank to engage in insurance and possibly other nonbanking activities that are prohibited to it by section 4(c)(8). We do not believe, however, that Federal laws are subject to repeal by compliant State legislators.

The establishment of limits on the activities of bank holding companies and all of their subsidiaries has always been the sole prerogative of Congress. Title VI provides that for purposes of section 4(c)(8), "* * * it is not closely related to banking for a bank holding company to provide insurance * * *". The House Conference Report explaining title VI states that this language, "* * * generally prohibits bank holding companies and their subsidiaries from providing insurance, including property and casualty insurance products, as a principal, agent or a broker, with six specific exceptions enumerated in the title." (House Report No. 97-899, p. 91).

The key word is subsidiaries. This and other expressions of legislative intent leave no doubt that title VI applies to all components of a bank holding company.

This hearing is being held because those advocating the use of State law and State-chartered bank subsidiaries as a way for bank holding companies to get around title VI have caused considerable confusion and controversy. Other States, in addition to South Dakota, have expressed interest in this loophole or have started actively considering such legislation.

We support the so-called Dodd amendment in order to put this matter to rest. The Dodd language, which was passed last year by the Senate, reads, "Section 4(c)(8) of the Bank Holding Company Act of 1956 [12 U.S.C. 1843(c)(8)] is amended by inserting between the words "bank holding company" and "to provide insurance" the words "or any subsidiary or affiliate thereof."

The words "or any subsidiary or affiliate thereoff" further clarify the scope of title VI for those who need such clarification and explicitly inform bank holding companies that title VI covers all of their subsidiaries, including State-chartered banks.

Mr. Chairman, section 2(b) of H.R. 5916, which you and Mr. Wylie introduced in the 98th Congress, and related report language would have the identical effect of the Dodd amendment.

States' rights are not at issue here. The Dodd language does not change the right of any State to authorize insurance or other activities for the free-standing banks that they charter. Free-standing State banks, not affiliated with a bank holding company, would continue to exercise any powers deemed appropriate by their legislature.

Restrictions on State banks that affiliate with bank holding companies are, however, eminently fair. State banks become part of a holding company system to avoid restrictions on branching and to obtain tax advantages. When they elect to benefit from federal law they also become subject to its restrictions, including title VI. State banks cannot have it both ways and pick the provisions with which they wish to comply.

It is important to emphasize that legislative history and regulatory interpretation show that title VI has always applied to all subsidiaries of a bank holding company. We have provided the committee with a legal brief in a recent civil action which conclusively demonstrates this point.[1]

The amendment we support breaks no new legislative ground and overturns no recognized states' rights or dual banking system concepts. It simply clarifies existing law to resolve the State law controversy.

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[1] See footnote in Mr. Ream's prepared statement.

Mr. Chairman, the Insurance Producers Coalition strongly urges you and your distinguished sub-committee to bring this amendment to the House floor in an appropriate manner.

Thank you.

[The prepared statement of Mr. Ream on behalf of the National Association of Professional Insurance Agents [PIA] and other associations that represent producers that sell and service insurance in the United States, follows:]

Testimony of the
INSURANCE PRODUCER COALITION*

by

David L. Ream, CIC, CPIA
Chairman
Government Affairs Committee

of the National Association of
Professional Insurance Agents

concerning

THE SO-CALLED SOUTH DAKOTA LOOPHOLE

Presented before the

Subcommittee on Financial Institutions
Supervision, Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

September 11, 1985

*Independent Insurance Agents of America
National Association of Casualty & Surety Agents
National Association of Insurance Brokers
National Association of Life Underwriters
National Association of Professional Insurance Agents
National Association of Surety Bond Producers

Good afternoon, Mr. Chairman. The Insurance Producers Coalition is delighted that you are holding this hearing and appreciates this opportunity to support an amendment to resolve the so-called "South Dakota" issue. I am David L. Ream, CIC,CPIA, an independent insurance agent from Cleveland, Ohio. I am a Vice President of the National Association of Professional Insurance Agents (PIA) and Chairman of PIA's Government Affairs Committee. I am also speaking on behalf of the Independent Insurance Agents of America, National Association of Casualty and Surety Agents, National Association of Insurance Brokers, National Association of Life Underwriters, and National Association of Surety Bond Producers. With me is our legal counsel, Jonathan B. Sallet. These associations represent most of the producers that sell and service insurance in the United States.

The "South Dakota" issue arose because of the efforts of a large bank holding company to evade the clear language and intent of Title VI of the Garn-St Germain Depository Institutions Act of 1982. Garn-St Germain amended Section 4(c)(8) of the Bank Holding Company Act to prohibit insurance activities by banks, subject only to a few limited exceptions.

Citicorp nevertheless has attempted to acquire a South Dakota bank in order to evade the restrictions of Garn-St Germain. It has promoted this alleged loophole by arguing that Title VI only applies to nonbanking subsidiaries of a bank holding company. In other words, Citicorp argues that Congress intended to permit banking subsidiaries to sell insurance while simultaneously prohibiting nonbanking subsidiaries from engaging in precisely the same activity. Citicorp's contention is nonsensical.

It is important to recognize that Citicorp's argument does not apply to South Dakota alone. We face not just a "South Dakota" loophole but a much broader "state law" loophole that would allow any state to strip away the protections of the Act. The critical issue, therefore, is whether the prohibitions of Title VI apply to bank holding companies and all of their subsidiaries, bank and nonbank alike, no matter how the holding company is structured or where its subsidiaries are located.

The answer to this question is simple. Title VI applies to the entire holding company system. Were this otherwise, a bank holding company need only find a receptive general assembly, have a favorable law enacted, and use its state-chartered bank to engage in insurance and possibly other nonbanking activities that are prohibited to it by Section 4(c)(8). We do not believe, however, that federal laws are subject to repeal by compliant state legislators.

The establishment of limits on the activities of bank holding companies and all of their subsidiaries has always been the sole prerogative of Congress. Title VI provides that for purposes of Section 4(c)(8), " ... it is not closely related to banking for a bank holding company to provide insurance ...". The House Conference Report explaining Title VI states that this language,

> " ... generally prohibits bank holding companies and their subsidiaries from providing insurance, including property and casualty insurance products, as a principal, agent, or a broker, with six specific exceptions enumerated in the Title."
>
> (House Report No. 97-899, P. 91).

The key word is "subsidiaries." This and other expressions of legislative intent leave no doubt that Title VI applies to all components of a bank holding company.

This hearing is being held because those advocating the use of state law and state-chartered bank subsidiaries as a way for bank holding companies to get around Title VI have caused considerable confusion and controversy. Other states, in addition to South Dakota, have expressed interest in this loophole or have started actively considering such legislation.

We support the so-called Dodd Amendment in order to put this matter to rest. The Dodd language, which was passed last year by the Senate, reads,

> "Section 4(c)(8) of the Bank Holding Company Act of 1956 [12 U.S.C. 1843(c)(8)] is amended by inserting between the words "bank holding company" and "to provide insurance" the words "or any subsidiary or affiliate thereof".

The words "or any subsidiary or affiliate thereof," further clarify the scope of Title VI for those who need such clarification and explicitly inform bank holding companies that Title VI covers all of their subsidiaries, including state-chartered banks.

Mr. Chairman, Section 2(b) of H.R.5916, which you and Mr. Wylie introduced in the 98th Congress, and related report language would have the identical effect of the Dodd Amendment.

States' rights are not at issue here. The Dodd language does not change the right of any state to authorize insurance or other activities for the freestanding banks that they charter. Freestanding state banks, not affiliated with a bank holding company, would continue to exercise any powers deemed appropriate by their legislature.

Restrictions on state banks that affiliate with bank holding companies are, however, eminently fair. State banks become part of a holding company system to avoid restrictions on branching and to obtain tax advantages. When they elect to benefit from federal law they also become subject to its restrictions, including Title VI. State banks cannot have it both ways and pick the provisions with which they wish to comply.

It is important to emphasize that legislative history and regulatory interpretation show that Title VI has always applied to all subsidiaries of a bank holding company. We have provided the Committee with a legal brief in a recent civil action which conclusively demonstrates this point.[1.]

[1.] American Insurance Association, et al, v. H. Joe Selby, Acting Comptroller of the Currency, et al. Civil Action No. 85-1489, Aug. 16, 1985, U.S. Court of Appeals for the District of Columbia, Brief of the National Association of Life Underwriters and National Association of Professional Insurance Agents as Amici Curiae in support of Plaintiff's motion for summary judgment, PP 13-42.

The amendment we support breaks no new legislative ground and overturns no recognized states' rights or dual banking system concepts. It simply clarifies existing law to resolve the state law controversy.

Mr. Chairman, the Insurance Producers Coalition strongly urges you and your distinguished Committee to bring this amendment to the House Floor in an appropriate manner.

* * *

Chairman **St Germain**. Thank you, Mr. Ream.

Now we will hear from Thomas M. Sullivan of the American Insurance Association.

STATEMENT OF THOMAS M. SULLIVAN, COUNSEL, AETNA LIFE & CASUALTY CO., APPEARING ON BEHALF OF THE AMERICAN INSURANCE ASSOCIATION [AIA]

Mr. **Sullivan**. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, my name is Thomas M. Sullivan. I am counsel for the Aetna Life and Casualty Co. I am appearing today on behalf of the American Insurance Association. The AIA represents 177 property-casualty insurance companies. Our members account for one-third of the national market for property-casualty insurance, with written premiums in excess of $30 billion.

Mr. Chairman, as I have been listening to the very eloquent witnesses who have presented testimony to your subcommittee today, I could not help but think how difficult it would be to explain the reasons for this hearing to a visitor from another planet or, indeed, another country. As I understand it, the principal purpose of the hearing is to determine whether there is such a thing as a "South Dakota looophole" and, if there is, what should be done about it. Stated another way, the issue might be put as whether Congress means what it appears to have said in past legislative pronouncements or whether those governed by those pronouncements are free to interpret them as they see fit and as their interests demand.

You have said, Mr. Chairman, as recently as July 9 of this year, that you were concerned "that States and financial institutions not use loopholes in the law to bypass the intent of Congress." As you by now must be aware, that concern does not square with the attitude of certain bank holding companies which might be succinctly summarized in a paraphrase of an old Mother Goose rhyme: "For every activity under the Sun, We'll find a loophole if there be one. If we're in luck, Congress sent it. And if we're not, we'll invent it."

Not since June 25, 1876, when South Dakota hosted a brief but long-remembered engagement on the banks of the Little Big Horn River has South Dakota figured so prominently in the course of the Nation's history. Just prior to the passage of South Dakota Senate Bill 256 in 1983, I had the delightful experience of speaking telephonically with Governor Janklow. I came away from my chat with this energetic and engaging public servant with two impressions: One was that nothing in his experience had prepared the Governor to decide whether a bank holding company may engage in the underwriting or sale of insurance through the device of a bank or nonbank subsidiary of a State-chartered bank empowered by a State to engage in activities otherwise prohibited by Federal law to the parent bank holding company. My other impression was that Citicorp was very clever in recognizing this fact and seeking to capitalize on the Governor's understandable concern with his State's economic well-being.

But I ask you, Mr. Chairman, whether it should be incumbent on Governor Janklow and other State leaders to second-guess lobbyists for the Nation's most sophisticated banking interests who come to their doors offering jobs and capital in return for buying their version of what Congress has said.

It is perhaps unfortunately true that the best laws are those which are self-executing. To the extent that laws must depend on the good will and straight dealing of those whose actions they are intended to govern, there will always be "loopholes," real or imagined, intended or not.

I suggest it is abundantly clear what in congressional parlance is described by the term "bank holding company." That being so, we look to section 4(c)(8) of the Bank Holding Company Act as amended by the Garn-St Germain Act of 1982 and find that, subject to certain exceptions, Congress has said " * * * it is not closely related to banking * * * for a bank holding company to provide insurance as principal, agent or broker." Now we are told that that language does not mean what it seems to mean but rather that a bank holding company is able to avoid this prohibition on insurance activities merely by inserting a first- or-second tier subsidiary between it and the impermissible insurance activities. We respectfully suggest, Mr. Chairman, that this proposition defies logic as well as the expressed will of Congress.

Our view of section 4(c)(8) is that there is no loophole for insurance activities conducted by an subsidiary or affiliate of a bank holding company, whether that subsidiary or affiliate is a State-chartered bank or not. Nonetheless, since others have apparently perceived a loophole where we believe none exists, and since a proposal is now on the table to close it, I suppose we must assume the possibly metaphysically unstable position of our arguing that there is no loophole, but if there is one, it should be closed.

We thought that the Federal Reserve Board might, when confronted with this putative apparition, deny its existence. Instead, as you know, the Fed said it could not perceive it in the light provided by Citicorp's application to acquire a South Dakota State-chartered bank, but allowed of the possibility of being able to perceive it in a different light. Medieval scholars counting angels on pinheads would have loved this conundrum.

Contrary to some perceptions, this is not a States rights issue. Closing the South Dakota loophole will not affect the right of a State to regulate the free-standing banking institutions it charters or to authorize new activities for them. If a State determines that its free-standing banks should be allowed to engage in insurance activities, our association would most likely oppose the State legislation, but not on the grounds that the State was precluded by Federal law from doing so. But a State-chartered bank that is part of a holding company system must be bound by the entire Bank Holding Company Act, not just the parts that suit its purposes. To permit the States to allow State-chartered subsidiary or affiliate banks of bank holding companies to engage in activities prohibited to the bank holding companies themselves by the Bank Holding Company Act is to subvert the purpose of the act and subordinate Federal banking law to State law.

In sum, Mr. Chairman, the issue is in the hands of you and your colleagues. To do nothing would only exacerbate the present confusion and further the interests of those who seem dedicated to undermining clearly expressed congressional intent. My paraphrase of Mother Goose requires that I give you an accurate recitation of the rhyme: "For every problem under the Sun, There is a remedy, or there is none. If there be one, try to find it. If there be none, never mind it."

I think our panel today has established that there is a problem and that Congress cannot afford to "never mind it." Fortunately, the solution is at hand. It is section 2 of H.R. 5916 or its equivalent. We urge passage of this kind of prohibition and thank you for this opportunity to appear before you today.

[The prepared statement of Mr. Sullivan on behalf of the American Insurance Association [AIA] follows:]

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE HOUSE COMMITTEE
ON
BANKING, FINANCE AND URBAN AFFAIRS

September 11, 1985

Presented by Thomas M. Sullivan, Counsel
AEtna Life & Casualty

American
Insurance
Association

The American Insurance Association is a national
trade organization of casualty insurers.

Mr. Chairman and members of the Subcommittee, my name is Thomas M. Sullivan. I am Counsel for Ætna Life & Casualty. I am appearing today on behalf of the American Insurance Association. The American Insurance Association represents 177 property-casualty insurance companies. Our members account for one-third of the national market for property-casualty insurance, with written premiums over 30 billion dollars.

We appreciate the opportunity to appear before the Subcommittee to address an issue that has seriously threatened Congressional intent regarding the regulation of the nation's banking system. Mr. Chairman, in 1982 Congress passed the Garn-St Germain Depository Institutions Act of 1982. By passage of that bill, Congress stated unequivocally that the business of insurance is not closely related to banking, with a few enumerated exceptions. Certain prominent financial institutions, with the cooperation of certain states, are seeking to evade this clear statement of the will of Congress. Their efforts pose a major threat to effective federal regulation of bank holding companies. We are asking Congress, through this Subcommittee, to authoritatively dispel the myth of the so-called South Dakota loophole by reasserting its intent and thereby restoring some measure of order to the federal regulation of bank holding company systems.

It has long been the policy governing regulation of the nation's banks to separate banking from other forms of commerce. The uniqueness of banks, their special role in our economy, their importance in serving as the country's medium for transaction accounts, as a backup source of liquidity for all other institutions and as the key in the implementation of national monetary policy--all have been cited as justifying the federal safety net that banks alone enjoy. Because of their unique role, banks have been granted unique advantages vis-a-vis other commercial institutions, a grant which also confers unique responsibilities. To help ensure the safety and soundness of the banking system, Congress has periodically reaffirmed the policy of restricting banks and bank holding company systems from engaging in activities outside the traditional field of banking. This was the case in the enactment of the National Bank Act in 1864 and the Bank Holding Company Act of 1956. Consistent with this policy, and with particular regard to insurance activities of bank holding company systems, Congress spoke again with passage of the Garn-St Germain Act in 1982.

With the passage of the Garn-St Germain Act, it should have been clear to all concerned that Congress meant to prohibit bank holding companies from engaging directly or indirectly in all but a few enumerated insurance activities. This was set forth in the language of Section 4(c)(8) of the Bank Holding Company Act, as amended by the Garn-St Germain Act. That language provides that, subject to the exceptions, "it is not closely related to banking . . . for a bank holding company to provide insurance as principal, agent or broker." It defies logic that a bank holding company would be able to avoid this explicit prohibition on insurance activities merely through the device of inserting a first or second tier subsidiary between it and the impermissible insurance activity.

Our view of Section 4(c)(8) is that there is no loophole for insurance activities conducted by any subsidiary or affiliate of a bank holding company, whether that subsidiary or affiliate is a state-chartered bank or not. I suppose this places us in the somewhat ironic position of asking Congress to close a loophole that we do not necessarily agree exists. Yet, because of the unstinting efforts of certain banking interests to convince state legislators that such a loophole does indeed exist in the Bank Holding Company Act, we think that there is a compelling need for Congressional resolution.

The efforts in question began when the ink was barely dry on the Garn-St Germain Act, and by 1983 certain money center bank holding companies had successfully persuaded South Dakota to pass a statute granting insurance powers to its state-chartered banks. The statute encouraged out-of-state bank holding companies to acquire or establish a South Dakota bank the activities of which would be limited, as a practical matter, to exporting insurance services to states other than South Dakota. The South Dakota legislature was enticed by the prospects of additional jobs and revenue for the state. This is a siren song that is perhaps understandably difficult for states to resist. Nonetheless, it cannot be permitted if it means undermining federal banking law.

As you know, Mr. Chairman, the Federal Reserve Board rejected the application of Citicorp to acquire a state-chartered South Dakota bank which Citicorp intended to use as the vehicle for a nationwide insurance business under the new South Dakota statute. We applaud the Board's decision. However, we do not believe that it eliminates all doubts concerning the existence of the South Dakota loophole. Because, in the Board's view, Citicorp's proposed acquisition of a South Dakota bank was an undisguised effort to evade the restrictions of Section 4 of the Bank Holding Company Act, the Board found it unnecessary to determine whether the non-banking limitations of the Bank Holding Company Act apply to holding company banks. Thus, there is a very real possibility that this issue will continue to appear, though undoubtedly under varying circumstances each of which will require the expenditure of considerable time and money on the part of responsible federal regulators, to say nothing of private parties. Additional confusion is created when different regulatory agencies promulgate rules which emanate from philosophies which are apparently at odds with Congressional intent.

We believe that Congress should act to clarify its intent. The alternative to Congressional action is to leave the question of the South Dakota loophole to resolution by the courts or federal bank regulators. As to both of these possibilities, we believe Congress is eminently better situated to resolve this issue.

An issue that often arises in discussions of the South Dakota question is that of a state bank chartering authority's right to determine what activities its state banks will be allowed to conduct. Closing the South Dakota loophole will not affect the right of a state to regulate or authorize new activities for its free-standing state-chartered banks. If a state determines that its free-standing banks should be allowed to engage in insurance activities, then, although we would certainly not agree with the policy and would do our best to defeat it in the state's legislature, we do not see a South Dakota issue involved. It is important to emphasize, however, that state-chartered banks that are part of a holding company system must be bound by the entire Bank Holding Company Act, not just the parts they like. To permit the states to allow state-chartered subsidiary or affiliate banks of bank holding companies to engage in activities prohibited by the Bank Holding Company Act is to subvert the purpose of the Act and to subordinate federal banking law to state law, and perhaps to jeopardize the delicate balance of our entire banking system.

Banks are not required to organize as holding company systems. But there are certain advantages to holding company organization for state-chartered banks. Tax advantages are an important motivation for some banks. Further, holding companies, unlike free-standing banks, are able in some circumstances to avoid state restrictions on branching and interstate operation. Holding company banks, in receiving the advantage of holding company status, must also expect to comply with the restrictions of the federal Bank Holding Company Act, including the Section 4(c)(8) curbs on insurance activities.

The remedy for clarifying Section 4(c)(8) is readily at hand. It is found in Section 2 of H.R. 1513, a bill that you introduced earlier this year, Mr. Chairman. Section 2 of H.R. 1513 amends Section 4(c)(8) of the Bank Holding Company Act by inserting just five words--"or subsidiary or affiliate thereof"--that clarify that any component of a bank holding company is restricted by the provisions of Section 4(c)(8).

In other words, bank holding companies would be unable to utilize a state-chartered subsidiary to engage indirectly in insurance activities that it could not do directly. Language similar to that contained in Section 2 of H.R. 1513 was reported out of the House Banking Committee in the last Congress in H.R. 5916. Similar language, in the form of the so-called Dodd Amendment, passed the Senate last year. We believe the support and momentum is there to settle the South Dakota question. We urge the Subcommittee to move forward on closing the South Dakota loophole by reporting legislation containing Section 2 of H.R. 1513 as expeditiously as possible.

Mr. Chairman, we are pleased to have had the opportunity to share our views with you today and I would be pleased to respond to any questions you may have.

Chairman St Germain. I got the Mother Goose rhyme, and I did the Shakespeare niche. There was a flavor of Louis L'Amour; however, I missed Agatha Christie.

Mr. Sullivan. I wiil try to fit it in during my next appearance.

Chairman St Germain. If you will revise your remarks, you might want to do that.

We will be in recess for 10 minutes to go over and vote. We will come back shortly to have a round of questions.

[Recess.]

Chairman St Germain. The subcommittee will come to order. The Chair, at this time, recognizes the gentleman from Georgia for the questioning of witnesses.

Mr. Barnard. Mr. Chairman, thank you very much.

First of all, I want to compliment the entire panel for the very excellent testimony that was condensed in a specific period of time. And I believe you got all of your comments in at that time, and with reference to the South Dakota loophole, Mr. Chairman, I really have no questions of these gentlemen.

I would like to ask Mr. Roberts a question, though, which is of some interest to me. I am sure he is prepared to answer this question. He knew I was going to ask it.

Representing the Association of Bank Holding Companies, Mr. Roberts, and your support of H.R. 2707——

Mr. Roberts. Yes.

Mr. Barnard [continuing]. Do you think Congress ought to initiate legislation to make divesture of those who have more than 1 percent of the Nation's deposits.

Mr. Roberts. Congressman Barnard, we do support H.R. 2707 and commend the chairman and you and all Members. We commend the committee, but I said earlier that there were some aspects of that bill that we did have some concern about, and should that come to the floor, we wish to talk further about it, and the concentration issue is one. I personally feel, and I think the association does, that that kind of provision is not needed because I think there are more than adequate provisions in the laws today against concentration of power.

Mr. Barnard. I can say as one Member, I have not gotten the understanding that the association had any caveats at all as far as concentration, and I was sure that you would want us to go to that next step and require divesture of those institutions that were larger than 1 percent of the Nation's deposits.

Mr. Roberts. We strongly favor the action of the committee in advocating a date certain for nationwide interstate banking as it did.

Mr. Barnard. You are evading my question. I want you to know, Mr. Roberts, our chairman just absolutely detests people who do not answer the question.

Mr. Roberts. Well, on the question, Congressman——

Mr. Barnard. I don't, but he does.

Mr. Roberts. On the question of concentration, our association does not feel that the 1 percent limitation on concentration is needed. But if in fact Congress deems that there be a concentration provision in that bill, we don't feel legislating a numerical ratio is the way to go about it; it should; be addressed in another way, and would want to address that issue.

We did have a reservation on that particular provision.

Mr. BARNARD. The other one I want to compliment the Association of Bank Holding Companies for feeling, though, is that they are not doing as good a job as they should be doing in serving the community and thereby supporting the new provisions of the Community Redevelopment Act. I think that is a very noble objective when you can look at your own industry and see that you need to be policed. And I compliment you, Mr. Roberts. I am sure that bankers of America don't agree with you.

The Association of Bank Holding Companies has just been very stalwart in recognizing their own deficiencies.

Mr. ROBERTS. We have tried to be progressive as it relates to banking legislation.

Mr. BARNARD. I believe that, but not in this particular bill. I have no further questions, Mr. Chairman.

Chairman ST GERMAIN. Mr. Barnard, may I ask you a question?

Mr. BARNARD. I am not testifying, but I would be glad to answer it.

Chairman ST GERMAIN. I wonder if you would enlighten me. Do you need assistance from the staff to prepare the divestiture amendment?

Mr. BARNARD. I think the Association of Bank Holding Companies ought to do it. They are the ones that are in favor of it.

Chairman ST GERMAIN. Mr. Cooper?

Mr. COOPER. Thank you, Mr. Chairman. It is a pleasure to be with you today, and a particular pleasure to welcome Ken Roberts to this subcommittee. It is not often that we get the chance to hear testimony from a Tennessean who is a leader of a powerful large national association like the Association of Bank Holding Companies. We are proud that Mr. Roberts has been elected to that esteemed position, and proud to hear his testimony today.

It is also an honor for me to speak as dean of the Tennessee delegation on this. It is not often that someone who has been, the short time I have been a dean of anything. With the addition of Mr. Gordon to the committee, it is a pleasure to have you here before us.

I would like my comments to be general. It is worrisome for me, quite frankly, to hear the testimony of each one of you gentlemen. I think while there are folks on the committee who are pro one side or another, it would be of great help to us if there was some mechanism, some umbrella group where you could all resolve your differences on your own.

So often, as you know, business and trade groups can't decide a budget themselves, and they come to us to decide it for them. Some people like that, and many don't. It is tempting almost to want to lock you all in one room and see who comes out. I have confidence that Ken, being the largest on the board, would probably win out.

I hope you understand the point I am driving at. It is frustrating to get elected to Congress. It is frustrating to serve on a committee like this and have eight or nine people in front of you each of whom, in my opinion, has unclean hands to some extent.

It would be great if there were some way that we could rectify that situation. I am proud of banks and I am proud of the role they have played. And I would like to see broader asset powers, but I don't like the way they have handled credit life insurance, at least in Tennessee.

That has not been a noteworthy record of performance. Perhaps Mr. Ryan can enlighten me. Is ABA doing any systematic investigation into credit life insurance polices nationwide and how they are being handled in individual States and policing its own members to see whether the consumer is being served?

Mr. RYAN. Congressman Cooper, to respond to your question, I am not familiar with whether the ABA is doing the activities that you have suggested. I am not aware of what has gone on in Tennessee. I am aware of what goes on in California, and we think that the system is quite clean in California. We don't know there is a problem with it.

If I can respond to your earlier comments, perhaps your words may have influenced our friends in the insurance business to change their position, and we can resolve this right now.

Mr. COOPER. It seems to me—again, I am fairly new to this, but whichever industry you look at, it is hard to give you an "A-plus" as far as consistency is concerned, or really being interested in the welfare of the consumer. There are always angles or twists or selfish interest involved. I wish there would be some way you all could reconcile some of your differences so the consumer can be served.

Right now the problem is squarely in your lap. As I say, some of you will probably be happy with the outcome, some not. I am not sure in the end the consumers' interest is being served. So often the status quo is the only thing served. For instance, with the land title insurance, that to me is one of the most confusing, least efficient industries in our Nation. It is incredible we can buy multimillion-dollar pieces of equipment and 1 square foot of soil has to have its title traced back 200 years.

It is a situation common to this subcommittee, common on the other side of the Hill, as well, where the industry will come up and fight among themselves over turf. It is important for the particular industry, but I am afraid the person that loses out in the overall struggle is the consumer.

A year from now or 2 years from now, we could hear much of the same testimony, you all could use different arguments to justify our positions on that side. It is hard to come to a satisfying conclusion to this. That is one reason I think you have seen so little action from the committee in the last several years. Things basically are at a stalemate.

It is hard to decide, or at least for the average Member, to decide which is the right side. I don't mean to let my friends in the insurance industry off line. It is hard, when you have exempted users from antitrust provisions, et cetera, to really have much confidence in the form of organization. You certainly want Federal intervention now when it is convenient for your purposes.

I just would issue that parting wish, if you all could somehow resolve your differences more or less among yourselves, I think it would be a great help to the prosperity and future of all industries represented at this table.

Thank you, Mr. Chairman.

Chairman St Germain. Mr. Wylie.

Mr. Wylie. Thank you, Mr. Chairman.

Mr. Rattikin, I have heard from Mr. Sullivan on the issue of insurance before, and most of the other issues, but I have not had the opportunity to hear your testimony on the role of the insurance agency. I guess I was under the impression that title insurance agents function more or less the way agents do in other lines of insurance.

Could you explain a little more the role of a title insurance agent and the conflicts of interest that you believe are created if banks or other mortgage lenders were allowed to own title agencies?

There is a great distinction between the functions of title insurance agents and those of agents in other lines of insurance.

A title insurance agent does not function in a sales-related capacity. Instead, he performs the critical underwriting functions involved in issuing a title insurance policy.

An agent's substantive, underwriting functions include: First, identifying records and documents affecting title; second, examining these materials to determine their impact on the state of the title; third, determining the scope of insurance coverage that can be provided; fourth, preparing issuing the policy.

Natural tension exist in any insurance transaction between interest of insured in obtaining broadest protection possible and interest of underwriter in assuming only prudent and reasonable risks.

When the title insurance agent is owned by the bank to be insured under the policy, that agent faces inescapable conflict between: First interest of the insured, that is, the bank, in the broadest insurance protection and second, the fiduciary obligation of the agent to protect the underwriter from assuming imprudent or unreasonable risks.

Chairman St Germain. Excuse me, did you say underwriting issues, u-n-d-e-r-w-r-i-t-i-n-g?

Mr. Rattikin. Yes, sir.

Chairman St Germain. Underwriting issues as to who has title?

Mr. Rattikin. Underwriting questions as to whether the legal issues—it is the use of the word "underwriting," sir, is the legal issues as to determination of the title and who has those rights to the title. That is an underwriting question, not by the form of like a normal life underwriter, as such. Did I make myself clear?

Chairman St Germain. There are some of us up here who have done title searches, Mr. Rattikin, so don't overdo it. It is a piece of cake.

Mr. Rattikin. I used to have hair before I started this.

Mr. Wylie. I respectfully disagree it is a piece of cake. I gave up doing title searches because I had three other guys who were supposed to be experts in the business, and they missed 6 feet on a lot line and fortunately, for me, I stayed up all night and found it and went down to the county engineer's office, and that is when I said "No more of this for me."

What would be the consequences if banks got in the title insurance business? The life insurance people have one view, property and casualty have another view. This is a little different in perspective.

Mr. Rattikin, what do you see as the longrun consequences if Congress permits banks to enter the title insurance business?

Mr. RATTIKIN. With a green light from Congress, many mortgage banks will be encouraged to establish captive title companies.

Once in the business, you can expect that the banks will try to send as much of their title insurance business as possible to those captive agencies.

Over time, independent title companies will either be bought out by banks or will find that there is an ever-shrinking base of business they can compete for.

Ultimately, you will end up with a segment of the title insurance industry that is owned and controlled by the banks.

A lender-dominated title insurance industry will pose many of the same problems that Congress has tried to struggle with in connection with the credit life insurance industry. Indeed, the problems will be worse, since title insurance requires far more underwriting judgments—judgments that should be made by an independent entity and not by an affiliate of a bank who is a party to the real estate transaction and for whose protection the policy will be issued.

Mr. WYLIE. I do have another question, Mr. Chairman, but I understand——

Chairman ST GERMAIN. Go ahead.

Mr. WYLIE. I think the reason for these hearings today is emphasized in the difference of opinion as to whether there is or is not a loophole in the law at the present time. Mr. Roberts says the South Dakota loophole has been mooted by the Federal Reserve. On the other hand, those of you from the industry say that we should carry out the intent of title VI.

Now, when the original Bank Holding Company Act, was amended back in 1970, the House Report said that we should limit insurance activities of bank holding companies by amending section 4 of the act, but we didn't say anything about the bank itself. The report language says it should be emphasized these insurance prohibitions apply only to the bank holding company and its nonbanking subsidiary and not to the bank subsidiary of the bank holding company and that "this is in keeping with the original concept of the 1956 act which was to regulate bank holding companies and not their subsidiary banks."

Now, title VI, of the Garn-St Germain bill also amends section 4 of the Bank Holding Company Act and it says "interest in nonbanking organizations"—so we didn't really get to the issue as to whether, it seems to me, title VI or the one bank holding company prohibited a bank subsidiary from getting into the insurance business. Am I right about that, Mr. Roberts?

Mr. ROBERTS. I think you are right, Congressman, I don't think it was made clear, but that is the essence of my point. My concern—I am not here to say I think what South Dakota did was right or fair. I don't.

My concern is the one thing that upsets everyone is they have said you can come up and export your insurance activities but not here. That is patently unfair.

My concern is the proposed legislation to close, that goes a great deal further and goes right into the heart of, I think, States' right in the dual banking system, because as I understand the proposal in H.R. 1513 and other bills, it says that you are going to say that any insurance related activities of any State banking subsidy of a holding company have to comply with the provisions of Garn-St Germain.

That goes right to the heart of States' power to charter and create authority in its own banks. And then further the second point says that if you seek to export any activities outside of the State that they have to comply with the national banking provisions. That also goes to the States' power—I don't think that is necessary.

The specific concern that you have has been mooted by the Federal Reserve Board, and, in fact, if you felt that something had to be done it seems to me all you have to say is that, hey, what you can't do is say you can't do it in our State, but you can do it elsewhere, which is a much simpler thing.

What I am deeply concerned about is the upset of the dual banking system, the States' rights concept, because I think it has been a creative, fertile laboratory, and the States should have the power to grant their banks opportunities to develop and do things in their home State.

Mr. WYLIE. Maybe the purposes of the bank holding company act are being evaded, and the soundness and safety of the banking system is in jeopardy?

Mr. ROBERTS. I do not think the safety and soundness of the banking system—there have been no shows of abuses in any way whatsoever by the proposed sale for insurance activities. In point of fact, there have been a number of studies done, and I think even Chairman Volcker testified on occasion, that when you look at the array of activity that a banking or bank holding company could engage in, insurance activities are probably the least risky, and probably ultimately would contribute to the safety and soundness of the banking system, because it relates to the same kind of business, it has intermingled, and there is no sign of any particular abuse as a result.

Mr. WYLIE. We may want some comment on that a little later on.

I thank you, Mr. Chairman, for indulging me an extra few minutes.

Chairman ST GERMAIN. Mr. McKinney.

Mr. MCKINNEY. Thank you, Mr. Chairman. My good friend Jim Cooper from Tennessee, I would simply say you almost quoted McKinney speech No. 1. The only difference I made between putting them in the same room was that we put them in the room with bread and water and no facilities, and then when they came out we passed some legislation.

I understand your frustration, I just have to say to my good friend, Jim Ryan, that he gets the award for frankness, and Tom Sullivan gets it for an area discourse on what Ph.D. thesis for English lit should sound like. I am not going to wander into this thicket, gentleman, because I have a couple of problems.

Mr. Rattikin, I just want to say to you briefly. I have purchased a few houses in a non-title insurance State, Connecticut. We just didn't have it for years. We had bonded attorneys. When I came down here I was told by my mortgage banker where I would go and get my title, where I would close—that is the way he said it, you will close at Chicago Title or close at Washington Title.

The mere suggestion that I would have a choice never entered into the conversation.

But I do understand what you do, and I do understand your concerns, because what you are really saying is that Chase Manhattan Bank will tell you where to go to close.

I do have some problems with the testimony of—Mr. Backlund and Mr. Roberts, I must say. We sat this morning and listened to FSLIC tell us one of the reasons they are almost broke is because Texas and California happen to have slightly insane State legislatures. They have thrifts which are falling off the cliffs because they are into hamburger stands, tunafish boat fleets, and cruise ships they can't find.

In fact, the great majority of FIDC failures, believe it or not, are in these two States. And in fact, a great majority of failures in both systems are, in fact, non-member State institutions.

But the problem is we insure them. Not too many years ago this committee and the Congress put the full faith and credit of the U.S. Government, which means you and I, behind all of these institutions.

I guess what I am saying, is that having watched the insurance casualty business, underwriting business, bleed for a few years, and having watched the death throes of Penn Square, Sea-First, and Continental Illinois, I don't know why we don't ask them to do what they are doing better for awhile.

I remember almost getting thrown out of a window into whatever the bay is off of Newport, because I mentioned the conflicts, I said we have opened a cupboard door, half of you are going to jump in and fall out the other side because all of a sudden we gave it. There it was, equity, and they died, a lot of them. We we have been picking up the pieces every since.

These are great witnesses, Mr. Chairman, I find myself just as bad off when I first got here with regulation Q and commercial powers. I look at friends down the table and say I love you all, but just stay where you are for awhile.

Thank you.

Mr. Wylie. Mr. Chairman, I would like to ask unanimous consent to insert in the record at this point the report language from the Bank Holding Company Act Amendment by section 4, House Report Number 91-387. It is just one paragraph, and also the language of title VI, as it appears in section 4.

Chairman St Germain. Are you going to have your very excellent staff xerox those for the official reporter, if we give you unanimous consent for that purpose?

Mr. Wylie. I will. Thank you.

Chairman St Germain. Is there any objection?

The Chair hears none.

[The material referred to follows:]

EXCERPTS FROM HOUSE REPORT No. 91-387

91st Cong. 1st Sess. 15 (1969)

A majority of the committee agreed and rewrote section 4(c)(8) of the 1956 act accordingly, utilizing the key words of Chairman Martin. The rewritten proposal in pertinent part provides that with Federal Reserve Board approval a bank holding company may retain or acquire shares in any company performing any activity that the Board has determined "is functionally related to banking in such a way that its performance by an affiliate of a bank-holding company can reasonably be expected to produce benefits to the public that outweigh possible adverse effects."

Two specific prohibitions were added to the Board's approval authority under the revised section 4(c)(8). One would specifically prohibit the acquisition by a bank holding company of any company performing the functions of an insurance agent, or a bank holding company itself acting as an insurance agent. An exception is made to this prohibition where the insurance is limited to what is popularly called credit life, health and accident insurance. The other, would specifically prohibit a bank holding company from engaging in the underwriting, public sale or distribution of mutual funds.

It should be emphasized that these two prohibitions apply only to the bank holding company and its nonbanking subsidiaries, and not to the bank subsidiaries of bank holding companies whose insurance agency and mutual fund operations are governed by other Federal and State laws. This is in keeping with the original concept of the 1956 act which was to regulate bank holding companies and not their subsidiary banks.

SECTION 4 OF THE BANK HOLDING COMPANY ACT, AS AMENDED BY TITLE VI OF THE GARN-ST GERMAIN DEPOSITORY INSTITUTIONS ACT OF 1982

§ 1843. Interests in nonbanking organizations

(a) Ownership or control of voting shares of any company not a bank; engagement in activities other than banking

Except as otherwise provided in this chapter, no bank holding company shall—

(1) after May 9, 1956, acquire direct or indirect ownership or control of any voting shares of any company which is not a bank, or

(2) after two years from the date as of which it becomes a bank holding company, or in the case of a company which has been continuously affiliated since May 15, 1955, with a company which was registered under Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.], prior to May 15, 1955, in such a manner as to constitute an affiliated company within the meaning of that Act, after December 31, 1978, or, in the case of any company which becomes, as a result of the enactment of the Bank Holding Company Act Amendments of 1970, a bank holding company on December 31, 1970, after December 31, 1980, retain direct or indirect ownership or control of any voting shares of any company which is not a bank or bank holding company or engage in any activities other than (A) those of banking or of managing or controlling banks and other subsidiaries authorized under this chapter or of furnishing services to or performing services for its subsidiaries, and (B) those permitted under paragraph (8) of subsection (c) of this section subject to all the conditions specified in such paragraph or in any order or regulation issued by the Board under such paragraph: *Provided*, That a company covered in 1970 may also engage in those activities in which directly or through a subsidiary (i) it was lawfully engaged on June 30, 1968 (or on a date subsequent to June 30, 1968 in the case of activities carried on as the result of the acquisition by such company or subsidiary, pursuant to a binding written contract entered into on or before June 30, 1968, of another company engaged in such activities at the time of the acquisition), and (ii) it has been continuously engaged since June 30, 1968 (or such subsequent date). The Board by order, after opportunity for hearing, may terminate the authority conferred by the preceding proviso on any company to engage directly or through a subsidiary in any activity otherwise permitted by that proviso if it determines, having due regard to the purposes of this chapter, that such action is necessary to prevent undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices; and in the case of any such company controlling a bank having bank assets in excess of $60,000,000 on or after December 31, 1970, the Board shall determine, within two years after such date (or, if later, within two years after the date on which the bank assets first exceed $60,000,000), whether the authority conferred by the preceding proviso

with respect to such company should be terminated as provided in this sentence. Nothing in this paragraph shall be construed to authorize any bank holding company referred to in the preceding proviso, or any subsidiary thereof, to engage in activities authorized by that proviso through the acquisition, pursuant to a contract entered into after June 30, 1968, of any interest in or the assets of a going concern engaged in such activities. Any company which is authorized to engage in any activity pursuant to the preceding proviso or subsection (d) of this section but, as a result of action of the Board, is required to terminate such activity may (notwithstanding any otherwise applicable time limit prescribed in this paragraph) retain the ownership or control of shares in any company carrying on such activity for a period of ten years from the date on which its authority was so terminated by the Board.

The Board is authorized, upon application by a bank holding company, to extend the two year period referred to in paragraph (2) above from time to time as to such bank holding company for not more than one year at a time, if, in its judgment, such an extension would not be detrimental to the public interest, but no such extensions shall in the aggregate exceed three years. Notwithstanding any other provision of this chapter, the period ending December 31, 1980, referred to in paragraph (2) above, may be extended by the Board of Governors to December 31, 1984, but only for the divestiture by a bank holding company of real estate or interests in real estate lawfully acquired for investment or development. In making its decision whether to grant such extension, the Board shall consider whether the company has made a good faith effort to divest such interests and whether such extension is necessary to avert substantial loss to the company.

(b) Statement purporting to represent shares of any company except a bank or bank holding company

After two years from May 9, 1956, no certificate evidencing shares of any bank holding company shall bear any statement purporting to represent shares of any other company except a bank or a bank holding company, nor shall the ownership, sale, or transfer of shares of any bank holding company be conditioned in any manner whatsoever upon the ownership, sale, or transfer of shares of any other company except a bank or a bank holding company.

(c) Exemptions

The prohibitions in this section shall not apply to (i) any company that was on January 4, 1977, both a bank holding company and a labor, agricultural, or horticultural organization exempt from taxation under section 501 of title 26, or to any labor, agricultural, or horticultural organization to which all or substantially all of the assets of such company are hereafter transferred, or (ii) a company covered in 1970 more than 85 per centum of the voting stock of which was collectively owned on June 30, 1968, and continuously thereafter, directly or indirectly, by or for members of the same family, or their spouses, who are lineal descendants of common ancestors; and such prohibitions shall not, with respect to any other bank holding company, apply to—

* * * * * * *

(8) shares of any company the activities of which the Board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto, but for purposes of this subsection it is not closely related to banking or managing or controlling banks for a bank holding company to provide insurance as a principal, agent, or broker except (A) where the insurance is limited to assuring repayment of the outstanding balance due on a specific extension of credit by a bank holding company or its subsidiary in the event of the death, disability, or involuntary unemployment of the debtor; (B) in the case of a finance company which is a subsidiary of a bank holding company, where the insurance is also limited to assuring repayment of the outstanding balance on an extension of credit in the event of **loss or damage to any property used as collateral on such extention [1] of credit and,** during the period beginning on October 15, 1982, and ending on December 31, 1982, such extension of credit is not more than $10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) and for any given year after 1982, such extension of credit is not more than an amount equal to

$10,000 ($25,000 in the case of an extension of credit which is made to finance the purchase of a residential manufactured home and which is secured by such residential manufactured home) increased by the percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers published monthly by the Bureau of Labor Statistics for the period beginning on January 1, 1982, and ending on December 31 of the year preceding the year in which such extension of credit is made; (C) any insurance agency activity in a place that (i) has a population not exceeding five thousand (as shown by the last preceding decennial census), or (ii) the bank holding company, after notice and opportunity for a hearing, demonstrates has inadequate insurance agency facilities; (D) any insurance agency activity which was engaged in by the bank holding company or any of its subsidiaries on May 1, 1982, or which the Board approved for such company or any of its subsidiaries on or before May 1, 1982, including (i) sales of insurance at new locations of the same bank holding company or the same subsidiary or subsidiaries with respect to which insurance was sold on May 1, 1982, or approved to be sold on or before May 1, 1982, if such new locations are confined to the State in which the principal place of business of the bank holding company is located, any State or States immediately adjacent to such State, and any State or States in which insurance activities were conducted by the bank holding company or any of its subsidiaries on May 1, 1982, or were approved to be conducted by the bank holding company or any of its subsidiaries on or before May 1, 1982, and (ii) sales of insurance coverages which may become available after May 1, 1982, so long as those coverages insure against the same types of risks as, or are otherwise functionally equivalent to, coverages sold on May 1, 1982, or approved to be sold on or before May 1, 1982 (for purposes of this subparagraph, activities engaged in or approved by the Board on May 1, 1982, shall include activities carried on subsequent to that date as the result of an application to engage in such activities pending on May 1, 1982, and approved subsequent to that date or of the acquisition by such company pursuant to a binding written contract entered into on or before May 1, 1982, of another company engaged in such activities at the time of the acquisition); (E) any insurance activity where the activity is limited solely to supervising on behalf of insurance underwriters the activities of retail insurance agents who sell (i) fidelity insurance and property and casualty insurance on the real and personal property used in the operations of the bank holding company or any of its subsidiaries, and (ii) group insurance that protects the employees of the bank holding company or any of its subsidiaries; (F) any insurance agency activity engaged in by a bank holding company, or any of its subsidiaries, which bank holding company has total assets of $50,000,000 or less: *Provided, however*, That such a bank holding company and its subsidiaries may not engage in the sale of life insurance or annuities except as provided in subparagraph (A), (B), or (C); or (G) where the activity is performed, or shares of the company involved are owned, directly, or indirectly, by a bank holding company which is registered with the Board of Governors of the Federal Reserve System and which, prior to January 1, 1971, was engaged, directly or indirectly, in insurance agency activities as a consequence of approval by the Board prior to January 1, 1971. In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. In orders and regulations under this subsection, the Board may differentiate between activities commenced de novo and activities commenced by the acquisition, in whole or in part, of a going concern. Notwithstanding any other provision of this chapter, if the Board finds that an emergency exists which requires the Board to act immediately on any application under this subsection involving a thrift institution, and the primary Federal regulator of such institution concurs in such finding, the Board may dispense with the notice and hearing requirement of this subsection and the Board may approve or deny any such application without notice or hearing;

Chairman St Germain. Gentlemen, your testimony has been so lucid, clear, telling, and penetrating, that I am going to forgo the opportunity to colloquial with you. My colleagues have done a good job of asking questions and spreading everything on the record nicely.

Now I would like to say this, I think there is one individual here who I don't want to have leave without—I am not talking about

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[1] So in original. Probably should be "extension."

you Mr. Ryan—I am hoping that he has recovered from his surgery and his illness and ailments—I am going to ask the Angel of Mercy.

Mr. **Googins**. I would like to thank you, Mr. Chairman.

Chairman **St Germain**. I am sending you a presentation that is for—you have, once again, and the award for the best testimony. With that, gentlemen, there may be some additional questions submitted in writing, but we do want to thank you for coming from California, Texas, Tennessee, Ohio, and Connecticut, and Mr. Backlund, refresh my memory——

Mr. **Backlund**. Bartonville, IL.

Chairman **St Germain**. Mr. Rauscher, you are from Virginia?

Mr. **Rauscher**. Bethesda.

Chairman **St Germain**. Seriously, we are very grateful and we will have additional questions to be submitted in writing.

If you would like to stay, I am now going to allow Mr. Barnard and Mr. McKinney to continue their debate. So those of you who would like to stay, you are welcome. No extra fee. I tell you what. if you register, you get to buy additional tickets. Are you going to revise and extend?

Mr. **McKinney**. I am exhausted and I simply say I know he is wrong and he knows I am right and we are both right.

Chairman **St Germain**. The subcommittee is in recess

[Whereupon, at 4:30 p.m., the subcommittee was recessed, to reconvene subject to the call of the Chair.]

[Letters of invitation to the witnesses to testify follow:]

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN

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STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

August 26, 1985

Mr. Charles Partee
Member, Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Partee:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 p.m., in Room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

Your prepared statement will be included in its entirety in the hearing record, and if 175 copies are delivered to the Subcommittee in Room B303 Rayburn House Office Building by 12:00 noon the day before the hearing, it will be distributed to all Members of the Subcommittee in advance of the hearing. To enable all Subcommittee Members sufficient time for questioning, your oral presentation of your testimony will be limited to five minutes.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

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TOBY ROTH WISCONSIN

August 26, 1985

Mr. Kenneth L. Roberts, Chairman
Association of Bank Holding Companies
730 15th Street, N.W.
Washington, D.C. 20005

Dear Mr. Roberts:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

The rules of the House Banking Committee require that you deliver 175 copies of your prepared statement to room B303 Rayburn by 12:00 noon the day before your scheduled appearance. Your prepared statement will be included in its entirety in the hearing record, and if delivered to the Subcommittee by the time specified, it will be distributed to all Members of the Subcommittee in advance of the hearing. To enable all Subcommittee Members sufficient time for questioning, your oral presentation of your testimony will be limited to five minutes.

Sincerely,

FJStGermain

Fernand J. St Germain
Chairman

FJStG:dDv

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TOBY ROTH, WISCONSIN

August 26, 1985

Mr. James G. Cairns, Jr., President
American Bankers Association
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Cairns:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

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Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

FERNAND J. ST GERMAIN, RHODE ISLAND, CHAIRMAN
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DOUG BEREUTER, NEBRASKA
STEVE BARTLETT, TEXAS
TOBY ROTH, WISCONSIN

August 26, 1985

Mr. Charles Backlund, President
Independent Bankers Association of America
1625 Massachusetts Avenue, N.W.
Washington, D.C. 20036

Dear Mr. Backlund:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

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Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

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TOBY ROTH, WISCONSIN

August 26, 1985

Mr. Robert R. Googins
Executive Vice President
American Council of Life Insurance
1850 K Street, N.W.
Washington, D.C. 20006

Dear Mr. Googins:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

The rules of the House Banking Committee require that you deliver 175 copies of your prepared statement to room B303 Rayburn by 12:00 noon the day before your scheduled appearance. Your prepared statement will be included in its entirety in the hearing record, and if delivered to the Subcommittee by the time specified, it will be distributed to all Members of the Subcommittee in advance of the hearing. To enable all Subcommittee Members sufficient time for questioning, your oral presentation of your testimony will be limited to five minutes.

Sincerely,

F J St Germain

Fernand J. St Germain
Chairman

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TOBY ROTH, WISCONSIN

August 26, 1985

Mr. Jack Rattikin, Jr., President
American Land Title Association
Suite 705
1828 L Street, N.W.
Washington, D.C. 20036

Dear Mr. Rattikin:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

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Sincerely,

F J St Germain
Fernand J. St Germain
Chairman

FJStG:dDv

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August 26, 1985

David L. Ream, CIC, CPIA
Chairman, Government Affairs Committee
National Association of Professional Insurance Agents
Suite 203
600 Pennsylvania Avenue, S.E.
Washington, D.C. 20003

Dear Mr. Ream:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

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Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

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TOBY ROTH WISCONSIN

August 26, 1985

Mr. Thomas M. Sullivan
c/o American Insurance Association
Suite 415
1025 Connecticut Ave., N.W.
Washington, D.C. 20036

Dear Mr. Sullivan:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

The rules of the House Banking Committee require that you deliver 175 copies of your prepared statement to room B303 Rayburn by 12:00 noon the day before your scheduled appearance. Your prepared statement will be included in its entirety in the hearing record, and if delivered to the Subcommittee by the time specified, it will be distributed to all Members of the Subcommittee in advance of the hearing. To enable all Subcommittee Members sufficient time for questioning, your oral presentation of your testimony will be limited to five minutes.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

cc: Mr. William Larson
[illegible]

FERNAND J ST GERMAIN RHODE ISLAND CHAIRMAN

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STEVE BARTLETT TEXAS
TOBY ROTH WISCONSIN

September 6, 1985

Mr. Frank A. Rauscher
Consumer Bankers Association
1300 North 17th Street
Suite 1200
Arlington, VA 22209

Dear Mr. Rauscher:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are requested to appear before this Subcommittee on September 11, 1985, at 2:00 pm, in room 2128 of the Rayburn House Office Building, to provide testimony regarding the so-called "South Dakota" issue -- the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

The rules of the House Banking Committee require that you deliver 175 copies of your prepared statement to room B303 Rayburn by 12:00 noon the day before your scheduled appearance. Your prepared statement will be included in its entirety in the hearing record, and if delivered to the Subcommittee by the time specified, it will be distributed to all Members of the Subcommittee in advance of the hearing. To enable all Subcommittee Members sufficient time for questioning, your oral presentation of your testimony will be limited to five minutes.

Sincerely,

Fernand J. St Germain
Chairman

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TOBY ROTH WISCONSIN

August 26, 1985

Honorable William M. Isaac, Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Chairman Isaac:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are invited to submit a statement for the record of the hearings to be held on September 10, 1985, regarding the so-called "South Dakota" issue — the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

Your prepared statement will be included in its entirety in the hearing record, and if 175 copies are delivered to the Subcommittee in Room B303 Rayburn House Office Building by 12:00 noon the day before the hearing, it will be distributed to all Members of the Subcommittee in advance of the hearing.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

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TOBY ROTH WISCONSIN

August 26, 1985

Mr. H. Joe Selby
Acting Comptroller of the Currency
Department of the Treasury
490 L'Enfant Plaza East, S.W.
Washington, D.C. 20219

Dear Mr. Selby:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are invited to submit a statement for the record of the hearings to be held on September 10, 1985, regarding the so-called "South Dakota" issue — the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

Your prepared statement will be included in its entirety in the hearing record, and if 175 copies are delivered to the Subcommittee in Room B303 Rayburn House Office Building by 12:00 noon the day before the hearing, it will be distributed to all Members of the Subcommittee in advance of the hearing.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

U.S. HOUSE OF REPRESENTATIVES
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OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

August 26, 1985

Mr. Walter C. Madsen
Conference of State Bank Supervisors
1015 18th Street, N.W.
Washington, D.C. 20036

Dear Mr. Madsen:

To assist the Financial Institutions Subcommittee in its legislative deliberations, you are invited to submit a statement for the record of the hearings to be held on September 10, 1985, regarding the so-called "South Dakota" issue — the authority of a State to preclude banks chartered by it and insured by the Federal government from conducting certain nonbanking activities within that State, yet permit these same banks to conduct such activities in other states.

Your prepared statement will be included in its entirety in the hearing record, and if 175 copies are delivered to the Subcommittee in Room B303 Rayburn House Office Building by 12:00 noon the day before the hearing, it will be distributed to all Members of the Subcommittee in advance of the hearing.

Sincerely,

Fernand J. St Germain
Chairman

FJStG:dDv

APPENDIX

Additional Material Submitted for Inclusion in the Record

The attached letter of August 1, 1985 was sent to Chairman Paul A. Volcker, Board of Governors of the Federal Reserve System requesting data regarding the depository institutions and holding companies under their jurisdiction. The letter was also sent to the Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, Office of the Comptroller of the Currency, and the National Credit Union Administration. Responses received from the above Federal agencies are attached.

[illegible]

U.S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
NINETY-NINTH CONGRESS
WASHINGTON, DC 20515

[illegible]

August 1, 1985

Honorable Paul A. Volcker
Chairman, Board of Governors
Federal Reserve System
Washington, D.C. 20551

Dear Chairman Volcker:

To assist this Subcommittee in the conduct of its responsibilities, each of the federal agencies supervising depository institutions and holding companies, is requested to provide the Subcommittee on or before September 6, 1985, with the information specified below for those institutions for which each has primary supervisory responsibility.

It is requested that the specified information be provided in the form of annual statistics on as a consistent a basis as feasible from year-end 1960 through the most recent period available. To enhance the utility of the information provided, the agencies are further requested to arrange to have their responses be as uniform in presentation as possible. If definitions, coverage, etc. have changed significantly, please so indicate in each of the responses and identify the time periods when such changes occured.

Please provide for each type of institution or holding company, in the aggregate with the data weighted by assets or deposits, and for appropriate large, medium and small size categories, the following:

1. Number and total assets of "problem" organizations;
2. Number and total assets of organizations failed or absorbed to avert failure;
3. Primary capital as a percentage of total assets;
4. Primary capital less classified assets (defined as the sum of: 1/2 substandard, 1/2 doubtful, plus all of loss assets), as a percentage of total assets;
5. Primary capital less classified assets (defined as above), as a percent of total assets including standby letters of credit and other off-balance sheet items;
6. Classified assets (defined as above) and nonperforming assets, as a percent of total assets;
7. Classified (defined as above) and nonperforming energy loans, agricultural loans, international loans, and real estate development loans and investments, each as percentage of primary capital;
8. Purchased funds and brokered deposits, each as a percent of total assets;
9. Net income as a percent of equity capital; and
10. Any other information that would augment the Subcommittee's understanding of the current status of the finanacial condition generally of depository organizations.

My staff is available to dicuss this request with you.

I look forward to and appreciate your cooperation in meeting the information needs of the Subcommittee.

Sincerely,

Fernand J. St Germain
Chairman

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

PAUL A. VOLCKER
CHAIRMAN

September 4, 1985

The Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions Supervision,
Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

In response to your letter of August 1, a packet of tables is enclosed providing data on state member banks and bank holding companies. The tables are preceded by some brief comments regarding the submission. This information reflects the results of discussions held with members of your staff and representatives of the other federal agencies supervising depository institutions.

As discussed with members of your staff, the Federal Reserve does not have results of bank holding company inspections in a computerized data base with sufficient detail to answer questions 4, 5, and 6. Thus, we are presently compiling this information, and expect to submit our response to the Subcommittee in the near future.

I hope the enclosed material will assist the Subcommittee in its deliberations.

Sincerely,

Paul

Enclosures

Notes Regarding the Federal Reserve Board's Submission of Data

- The Federal Deposit Insurance Corporation will provide responses to questions 1 and 2, and on brokered deposits in question 8 for all insured commercial banks. The Office of the Comptroller of the Currency will provide data on loans classified due to transfer risk for all insured commercial banks in response to question 7. The Federal Reserve Board is providing data on classified energy loans and real estate loans for all insured commercial banks, also in response to question 7. In addition, the Federal Reserve Board is providing data on nonperforming loans and net charge-offs in the real estate, agricultural, and international areas in response to question 10.

- Data from bank Call Reports and bank holding company F.R. Y-9 Reports are not directly comparable with data from bank examination reports and bank holding company inspection reports. This is due to the intermittent nature of exam scheduling among banks and inspection scheduling among bank holding companies, whereas Call Reports and F.R. Y-9 Reports present data at a single particular date for all institutions. The source used for each response is noted at the bottom of each table.

° Information submitted by the Federal Reserve in response to question 7 is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. The SNC data is our only automated source of loan classifications aggregated by sector.

Question 1

Table 1

Number and Total Assets (in Billions) of Bank Holding Companies Rated Composite 4 or 5[1/]

	Asset Size Class				
As of Year-End	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All Bank Holding Companies	
	No.	No.	No.	No.	Total Assets
1984	158	8	7	173	$72
1983	121	6	4	131	21
1982	52	3	6	61	20
1981	23	3	7	33	48
1980	30	3	6	39	42
1979	27	6	7	40	31

[1/] Bank holding company ratings have been collected since 1979.

Source: Bank Holding Company Inspection Reports.

Question 3

Table 2

Equity and Loan Loss Reserves as a Percentage of Total Assets[1]

State Member Banks

As of Year-End	Asset Size Class			All State Member Banks
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	
1984	8.73	7.76	5.70	6.15
1983	8.96	8.17	5.44	5.98
1982	8.73	7.33	5.05	5.57
1981	8.71	7.31	4.94	5.51
1980	8.70	7.78	4.75	5.37
1979	8.55	7.64	4.77	5.38
1978	8.31	7.76	4.94	5.55
1977	8.27	7.81	5.19	5.80
1976	8.35	8.16	5.29	6.01
1975	8.46	8.27	5.43	6.18
1974	8.45	8.32	5.18	5.96
1973	8.25	7.93	5.25	6.00
1972	8.10	7.90	5.70	6.42
1971	8.31	8.39	6.23	6.96
1970	8.63	8.71	6.57	7.38
Memo: Primary Capital[2] to Total Assets				
1984	8.73	7.76	6.03	6.42
1983	8.96	8.18	5.52	6.05

---

[1] All figures are weighted averages.

[2] Reporting of data on primary capital began in 1983.

Source: Call Report.

Question 3

Table 3

Equity and Loan Loss Reserves as a Percentage of Total Assets[1]

All Bank Holding Companies With Assets Above $100 Million

As of Year-End	Asset Size Class: $100 Million-$300 Million	Asset Size Class: $300 Million-$1 Billion	Asset Size Class: Greater Than $1 Billion	All BHCs With Assets Above $100 Million
1984	7.39	7.28	6.19	6.33
1983	7.27	7.26	5.98	6.13
1982	7.21	7.08	5.55	5.71
1981	6.99	6.99	5.29	5.45
1980	7.01	7.05	5.14	5.30
1979	6.75	7.02	5.06	5.22
1978	6.66	6.94	5.16	5.32
1977	7.05	7.31	5.32	5.54
1976	7.19	7.31	5.53	5.74
1975	7.05	7.13	5.42	5.65

---

[1] All figures are weighted averages.

Source: Form F.R. Y-9.

Table 4

Examination-Determined Primary Capital Before and After Adjustment for Classified Assets as a Percentage of Total Assets[1/]

State Member Banks

As of Year-End	Asset Size Class: Less Than $300 Million		$300 Million - $1 Billion		Greater Than $1 Billion		All State Member Banks	
	Primary Capital to Assets	Adjusted Primary Capital to Assets	Primary Capital to Assets	Adjusted Primary Capital to Assets	Primary Capital to Assets	Adjusted Primary Capital to Assets	Primary Capital to Assets	Adjusted Primary Capital to Assets
1984	8.97	8.13	8.10	7.55	5.75	4.86	6.22	5.35
1983	8.88	8.09	8.03	7.50	5.38	4.51	5.91	5.07
1982	8.31	7.64	7.14	6.48	5.04	4.35	5.52	4.83
1981	8.41	7.90	7.72	6.96	4.16	3.69	4.80	4.32
1980	8.25	7.83	7.70	7.21	4.33	3.85	4.99	4.52
1979	8.09	7.74	7.57	7.14	4.25	3.70	4.90	4.39
1978	7.89	7.54	7.70	7.15	4.64	3.92	5.29	4.63
1977	7.91	7.50	7.40	6.67	4.74	3.72	5.41	4.50
1976	7.82	7.34	7.45	6.44	4.75	3.50	5.49	4.38
1975	7.83	7.28	7.54	6.68	4.54	3.07	5.34	4.07
1974	7.82	7.42	7.49	6.92	4.58	3.73	5.41	4.67
1973	7.63	7.31	6.99	6.57	4.80	4.32	5.55	5.11
1972	7.55	7.23	7.34	6.94	5.90	5.44	6.45	6.03
1971	8.04	7.65	8.32	8.02	7.35	6.54	7.66	7.03
1970	7.34	7.93	8.76	8.46	7.19	6.52	7.71	7.15

1/ Classified assets are defined as 20 percent of substandard assets plus 50 percent of doubtful assets plus 100 percent of loss assets. The most recent examination as of year-end was used. Due to the intermittent nature of exam scheduling among banks, these data do not cover uniform periods, and therefore may differ from capital figures derived from year-end Call Reports. All figures are weighted averages.

Source: Bank Examination Reports.

Question 5

Table 5

Primary Capital Less Classified Assets as a Percentage of Total Assets Plus Standby Letters of Credit[1/]

State Member Banks

As of Year-End	Asset Size Class Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	8.08	7.44	4.54	5.04
1983	8.05	7.42	4.12	4.70
1982	7.60	6.39	4.09	4.58
1981	7.85	6.87	3.45	4.08
1980	7.80	7.10	3.60	4.27
1979	7.71	7.05	3.50	4.19
1978	7.51	7.09	3.74	4.45
1977	7.47	6.61	3.56	4.34
1976	7.32	6.35	3.37	4.24
1975	7.26	6.58	2.95	3.94
1974	7.40	6.84	3.58	4.52
1973	7.31	6.57	4.32	5.11
1972	7.23	6.94	5.44	6.03
1971	7.65	8.02	6.54	7.03
1970	7.93	8.46	6.52	7.15

[1/] Classified assets are defined as 20 percent of substandard assets plus 50 percent of doubtful assets plus 100 percent of loss assets. The most recent examination as of year-end was used. All figures are weighted averages.

Source: Bank Examination Reports.

Question 6

Table 6

Classified Assets as a Percentage of Total Assets

State Member Banks

As of Year-End	Asset Size Class: Less Than $300 Million	Asset Size Class: $300 Million-$1 Billion	Asset Size Class: Greater Than $1 Billion	All State Member Banks
1984	0.84	0.55	0.89	0.87
1983	0.79	0.53	0.87	0.84
1982	0.67	0.66	0.69	0.69
1981	0.51	0.47	0.48	0.48
1980	0.40	0.50	0.48	0.47
1979	0.34	0.43	0.54	0.51
1978	0.35	0.55	0.72	0.66
1977	0.41	0.73	1.02	0.91
1976	0.47	1.00	1.25	1.11
1975	0.54	0.86	1.47	1.27
1974	0.39	0.57	0.85	0.75
1973	0.32	0.42	0.48	0.44
1972	0.32	0.39	0.46	0.42
1971	0.39	0.31	0.80	0.63
1970	0.41	0.30	0.68	0.55

1/ Classified assets are defined as 20 percent of substandard assets plus 50 percent of doubtful assets plus 100 percent of loss assets. The most recent examination as of year-end was used. All figures are weighted averages.

Source: Bank Examination Reports.

Question 6

Table 7

Nonperforming Assets as a Percentage of Total Assets[1]

State Member Banks

As of Year-End	Asset Size Class Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	1.73	1.34	2.03	1.95
1983	1.66	1.26	1.89	1.83
1982	1.73	1.75	1.78	1.78

---

[1] Nonperforming assets are defined as loans and leases past due 90 days or more and still accruing, nonaccrual and renegotiated loans and leases, and other real estate owned. All figures are weighted averages.

Source: Call Report.

Question 7

Table 8

Classified Energy Loans as a Percentage of Equity Plus Loan Loss Reserves[1/]

State Member Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	0	0	1.96	1.94
1983	.52	0	1.55	1.53
1982	0	0	.17	.16
1981	0	0	.08	.08
1980	0	0	.06	.06
1979	0	0	.15	.15
1978	0	0	.36	.35
1977	0	0	.20	.20

[1/] The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call Reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified energy credits.

Question [illegible]

Table 9

Classified Real Estate Loans as a Percentage of Equity Plus Loan Loss Reserves[1]

State Member Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	0	0	.29	.29
1983	0	.08	.14	.14
1982	0	.17	.05	.05
1981	0	.09	.09	.09
1980	0	.42	.17	.17
1979	0	0	.11	.11
1978	0	0	.23	.23
1977	.05	.45	.35	.35

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[1] The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call Reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified real estate credits.

Question 7

Table 10

Classified Energy Loans as a Percentage of Equity Plus Loan Loss Reserves[1]

National Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All National Banks
1984	.41	1.03	3.22	3.13
1983	.35	.87	2.85	2.73
1982	.01	.07	.63	.59
1981	0	0	.40	.37
1980	0	0	.12	.11
1979	.06	.08	.28	.27
1978	0	.01	.43	.40
1977	0	.01	.24	.22

1/ The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call Reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified energy credits.

Question 7

Table 11

Classified Real Estate Loans as a Percentage of Equity Plus Loan Loss Reserves[1]

National Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All National Banks
1984	.02	.03	.34	.33
1983	.01	.02	.16	.15
1982	.02	.06	.08	.08
1981	.04	.02	.16	.16
1980	.24	.22	.24	.23
1979	.92	.18	.19	.19
1978	.79	.19	.39	.39
1977	.66	.29	.66	.63

---

[1] The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call Reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified real estate credits.

Question

Table 12

Classified Energy Loans as a Percentage of Equity Plus Loan Loss Reserves[1]

State Nonmember Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Nonmember Banks
1984	1.05	1.14	.24	.57
1983	1.76	2.58	1.29	1.66
1982	.96	.98	.09	.45
1981	0	0	.13	.09
1980	.25	0	.04	.07
1979	0	0	.13	.10
1978	0	.73	.16	.24
1977	0	.81	.14	.29

---

[1] The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call Reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified energy credits.

Question 7

Table 13

Classified Real Estate Loans as a Percentage of Equity Plus Loan Loss Reserves[1]

State Nonmember Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Nonmember Banks
1984	.42	0	.67	.47
1983	.11	.02	.03	.04
1982	0	0	0	0
1981	.02	.12	.03	.04
1980	.08	.14	.09	.09
1979	.10	.12	.20	.18
1978	.23	.18	.16	.17
1977	1.54	.06	.25	.40

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[1] The ratios represent classified loans in the Shared National Credit Program weighted on the basis of 20 percent of substandard loans plus 50 percent of doubtful loans plus 100 percent of loss loans to equity capital plus loan loss reserves as reflected in the June 30 Call reports for 1977 through 1984. All figures are weighted averages.

Source: The above information is derived from the annual interagency program for review and classification of Shared National Credits (SNC). A SNC is defined as any loan or group of loans to a borrower aggregating $20 million or more, either outstanding or committed under a formal lending agreement and (a) shared at its inception by two or more banks; or (b) a portion of which is sold to one or more banks with the purchasing bank assuming its pro-rata share of the credit risk. Therefore the above data are not meant to represent the full extent of classified real estate credits.

Question 8

Table 14

Volatile Liabilities as a Percentage of Total Assets[1]

State Member Banks

As of Year-End	Asset Size Class: Less Than $300 Million	Asset Size Class: $300 Million-$1 Billion	Asset Size Class: Greater Than $1 Billion	All State Member Banks
1984	12.69	22.32	52.94	46.80
1983	11.73	20.36	53.51	46.96
1982	13.57	26.15	58.00	51.43
1981	14.18	27.64	58.49	51.69
1980	13.04	23.82	54.66	48.20
1979	13.32	25.78	51.23	45.33
1978	12.43	24.59	51.11	44.48
1977	10.66	18.79	48.14	40.85
1976	10.46	17.69	48.24	39.86

1/ Volatile liabilities are defined as all time deposits over $100 thousand, foreign-office deposits, federal funds purchased and securities sold under agreements to repurchase, interest-bearing demand notes (note balances) issued to the U.S. Treasury, and other liabilities for borrowed money. Data on interest-bearing demand notes issued to the U.S. Treasury have been available only since 1978. All figures are weighted averages.

Source: Call Report.

Question 8

Table 15

Purchased Funds as a Percentage of Total Assets[1]

Bank Holding Companies With Assets Above $100 Million

	Asset Size Class			
As of Year-End	$100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All BHCs With Assets Above $100 Million
1984	15.75	19.62	40.70	38.02
1983	15.97	18.66	43.02	40.11
1982	20.00	22.66	48.28	45.54
1981	22.34	24.92	51.26	48.80
1980	20.18	22.34	49.43	47.04
1979	18.50	19.97	48.34	45.81
1978	17.90	19.35	47.14	44.43
1977	14.73	17.55	44.[illegible]7	41.35
1976	13.24	18.12	43.66	40.43

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[1] Purchased funds are defined as all time deposits over $100 thousand, foreign-office deposits, federal funds purchased and securities sold under agreements to repurchase, commercial paper, and other borrowings with an original maturity of one year or less. All figures are weighted averages.

Source: Form F.R. Y-9.

Question 9

Table 16

Net Income as a Percentage of Equity[1]

State Member Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	9.43	12.36	11.96	11.58
1983	8.01	10.69	12.70	11.58
1982	10.48	12.48	12.10	11.85
1981	10.88	12.03	13.06	12.58
1980	11.89	11.85	13.24	12.87
1979	12.09	12.47	11.88	11.98
1978	11.92	12.36	10.67	11.07
1977	11.42	11.40	9.54	10.11
1976	10.46	10.61	9.79	10.04
1975	10.45	10.62	10.97	10.81
1974	10.92	11.98	11.89	11.68
1973	11.71	12.84	11.65	11.84
1972	11.55	12.53	11.00	11.36
1971	11.74	13.29	11.52	11.87
1970	11.72	13.75	10.90	11.58

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[1] All figures are weighted averages.

Source: Call Report.

Question 9

Table 17

Net Income as a Percentage of Total Assets[1/]

State Member Banks

	Asset Size Class			
	Less Than $300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All State Member Banks
1984	0.77	0.88	0.59	0.62
1983	0.84	0.81	0.60	0.64
1982	0.86	0.84	0.54	0.59
1981	0.89	0.81	0.57	0.62
1980	0.97	0.85	0.56	0.62
1979	0.97	0.89	0.50	0.58
1978	0.93	0.89	0.47	0.56
1977	0.88	0.82	0.45	0.53
1976	0.81	0.79	0.46	0.55
1975	0.79	0.77	0.49	0.57
1974	0.82	0.88	0.51	0.60
1973	0.86	0.89	0.51	0.61
1972	0.83	0.87	0.53	0.63
1971	0.86	0.98	0.61	0.71
1970	0.88	1.05	0.61	0.73

[1/] All figures are weighted averages.

Source: Call Report.

Table 18

Net Income as a Percentage of Equity

Bank Holding Companies With Assets Above $100 Million[1]

	Asset Size Class			
	$100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All BHCs With Assets Above $100 Million
1984	10.12	10.62	9.88	9.95
1983	9.19	11.09	11.24	11.11
1982	11.79	10.63	11.75	11.66
1981	12.82	11.24	12.60	12.51
1980	12.62	12.32	13.06	12.98
1979	13.68	13.13	13.49	13.47
1978	12.65	12.19	12.61	12.58
1977	11.05	10.44	11.48	11.34
1976	10.99	10.18	11.16	11.04
1975	10.52	9.21	11.13	10.86

1/ All figures are weighted averages.

Source: Form F.R. Y-9.

Question 9

Table 19

Net Income as a Percentage of Total Assets

Bank Holding Companies With Assets Above $100 Million[1/]

	Asset Size Class			All BHCs With Assets Above $100 Million
	$100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	
1984	0.68	0.70	0.53	0.55
1983	0.61	0.74	0.59	0.60
1982	0.78	0.69	0.58	0.59
1981	0.83	0.72	0.59	0.61
1980	0.82	0.79	0.60	0.61
1979	0.85	0.84	0.61	0.63
1978	0.77	0.77	0.58	0.60
1977	0.72	0.71	0.55	0.57
1976	0.73	0.69	0.55	0.57
1975	0.71	0.62	0.55	0.57

[1/] All figures are weighted averages.

Source: Form F.R. Y-9.

Question 10

Table 20

Nonperforming Real Estate Loans as a Percentage of Equity and Loan Loss Reserves[1]

State Member Banks With Assets Above $100 Million

As of Year-End	Asset Size Class $100 Million-$300 Million	 $300 Million-$1 Billion	 Greater Than $1 Billion	All State Member Banks With Assets Above $100 Million
1984	5.70	4.73	5.06	5.06
1983	6.29	6.31	5.54	5.68
1982	7.13	8.22	7.38	7.43

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[1] Nonperforming real estate loans are defined as real estate loans past due 90 days or more and still accruing, and nonaccrual and renegotiated real estate loans. Data are only available for banks with assets greater than $100 million. All figures are weighted averages.

Source: Call Report.

Question 10

Table 21

Nonperforming Real Estate Loans as a Percentage of Equity and Loan Loss Reserves[1/]

National Banks With Assets Above $100 Million

	Asset Size Class			
As of Year-End	$100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All Banks Greater Than $100 Million
1984	5.15	5.17	6.40	6.14
1983	5.02	4.87	7.18	6.64
1982	5.94	6.57	9.54	8.73

1/ Nonperforming real estate loans are defined as real estate loans past due 90 days or more and still accruing, and nonaccrual and renegotiated real estate loans. Data are only available for banks with assets greater than $100 million. All figures are weighted averages.

Source: Call Report.

Question 10

Table 22

Nonperforming Real Estate Loans as a Percentage of Equity and Loan Loss Reserves[1]

State Nonmember Banks With Assets Above $100 Million

As of Year-End	Asset Size Class $100 Million- $300 Million	$300 Million- $1 Billion	Greater Than $1 Billion	All Banks Greater Than $100 Million
1984	6.05	8.34	6.83	7.00
1983	5.76	8.42	9.71	7.60
1982	7.52	11.53	13.12	10.12

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[1] Nonperforming real estate loans are defined as real estate loans past due 90 days or more and still accruing, and nonaccrual and renegotiated real estate loans. Data are only available for banks with assets greater than $100 million. All figures are weighted averages.

Source: Call Report.

Question 10

Table 23

Real Estate Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves1/

State Member Banks With Assets Above $300 Million

	Asset Size Class		All State Member Banks With Assets Above $300 Million
	$300 Million-$1 Billion	Greater Than $1 Billion	
1984	0.16	0.20	0.20
1983	0.28	0.15	0.16
1982	0.50	0.16	0.19
1981	0.30	0.02	0.04
1980	1.06	0.03	0.13
1979	0.49	0.24	0.27
1978	0.21	0.70	0.64
1977	0.25	0.74	0.68
1976	1.28	1.39	1.38

1/ From 1976 through 1983, data are only available for banks with assets greater than $300 million. In 1984, the ratio for state member banks with assets less than $300 million was 0.53 percent. All figures are weighted averages.

Source: Call Report.

Question 10

Table 24

Real Estate Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1/]

	National Banks With Assets Above $300 Million		
	Asset Size Class		
	$300 Million-$1 Billion	Greater Than $1 Billion	All National Banks With Assets Above $300 Million
1984	0.33	0.60	0.57
1983	0.31	0.36	0.36
1982	0.34	0.21	0.23
1981	0.17	0.11	0.12
1980	0.08	0.07	0.07
1979	0.19	0.22	0.22
1978	0.33	0.65	0.60
1977	0.53	0.69	0.66
1976	0.87	1.03	1.00

[1/] From 1976 through 1983, data are only available for banks with assets greater than $300 million. In 1984, the ratio for national banks with assets less than $300 million was 0.45 percent. All figures are weighted averages.

Source: Call Report.

Question 10

Table 25

Real Estate Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

State Nonmember Banks With Assets Above $300 Million

	Asset Size Class		
	$300 Million-$1 Billion	Greater Than $1 Billion	All State Nonmember Banks With Assets Above $300 Million
1984	0.65	0.60	0.63
1983	0.37	0.30	0.33
1982	0.57	0.29	0.43
1981	0.41	0.27	0.35
1980	0.15	0.19	0.17
1979	0.27	0.33	0.30
1978	0.42	0.81	0.32
1977	0.64	0.61	0.63
1976	1.10	0.46	0.81

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[1] From 1976 through 1983, data are only available for banks with assets greater than $300 million. In 1984, the ratio for state nonmember banks with assets less than $300 million was 0.65 percent. All figures are weighted averages.

Source: Call Report.

Question 10

Table 26

Nonperforming Agricultural Loans as a Percentage of Equity and Loan Loss Reserves[1]

Reporting State Member Banks With Assets Above $100 Million

As of Year-End	Asset Size Class $100 Million-$300 Million	 $300 Million-$1 Billion	 Greater Than $1 Billion	All Reporting State Member Banks With Assets Above $100 Million
1984	5.05	2.81	0.36	0.63
1983	1.47	1.10	0.54	0.77
1982	2.92	0.87	0.41	0.61

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[1] Nonperforming agricultural loans equal the sum of agricultural loans past due 90 days or more and still accruing, and nonaccrual and renegotiated agricultural loans. Data are only available for banks with assets greater than $100 million. In 1982 and 1983, only banks with domestic office agricultural loans greater than one percent of domestic office loans reported these data. In 1984, only banks with domestic office agricultural loans greater than five percent of domestic office loans reported these data. All figures are weighted averages.

Source: Call Report.

Question 10

Table 27

Nonperforming Agricultural Loans as a Percentage of Equity and Loan Loss Reserves[1]

Reporting National Banks With Assets Above $100 Million

As of Year-End	Asset Size Class $100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All Reporting National Banks With Assets Above $100 Million
1984	8.55	2.43	2.49	2.85
1983	3.93	2.52	2.85	2.91
1982	3.23	2.82	2.31	2.44

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[1] Nonperforming agricultural loans equal the sum of agricultural loans past due 90 days or more and still accruing, and nonaccrual and renegotiated agricultural loans. Data are only available for banks with assets greater than $100 million. In 1982 and 1983, only banks with domestic office agricultural loans greater than one percent of domestic office loans reported these data. In 1984, only banks with domestic office agricultural loans greater than five percent of domestic office loans reported these data. All figures are weighted averages.

Source: Call Report.

Question 10

Table 28

Nonperforming Agricultural Loans as a Percentage of Equity and Loan Loss Reserves[1]

Reporting State Nonmember Banks With Assets Above $100 Million

As of Year-End	Asset Size Class $100 Million-$300 Million	$300 Million-$1 Billion	Greater Than $1 Billion	All Reporting State Nonmember Banks With Assets Above $100 Million
1984	5.94	1.71	0.81	2.24
1983	3.58	1.13	0.83	1.17
1982	2.25	1.32	1.17	1.59

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[1] Nonperforming agricultural loans equal the sum of agricultural loans past due 90 days or more and still accruing, and nonaccrual and renegotiated agricultural loans. Data are only available for banks with assets greater than $100 million. In 1982 and 1983, only banks with domestic office agricultural loans greater than one percent of domestic office loans reported these data. In 1984, only banks with domestic office agricultural loans greater than five percent of domestic office loans reported these data. All figures are weighted averages.

Source: Call Report.

Question 10

Table 29

Agricultural Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

	Reporting State Member Banks			
	Asset Size Class			
	Less Than $300 Million[2]	$300 Million-$1 Billion	Greater Than $1 Billion	All Reporting State Member Banks
1984	3.06	0.41	0.00	0.16

---

[1] All figures are weighted averages.

[2] For banks with assets less than $300 million, only those with agricultural loans greater than five percent of total loans reported these data.

Source: Call Report.

Question 10

Table 30

Agricultural Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

	Reporting National Banks			
	Asset Size Class			
	Less Than $300 Million[2]	$300 Million-$1 Billion	Greater Than $1 Billion	All Reporting National Banks
1984	4.01	0.31	0.49	0.71

---

[1] All figures are weighted averages.

[2] For banks with assets less than $300 million, only those with agricultural loans greater than five percent of total loans reported these data.

Source: Call Report.

Question 10

Table 31

Agricultural Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

Reporting State Nonmember Banks

	Asset Size Class			
	Less Than $300 Million[2]	$300 Million-$1 Billion	Greater Than $1 Billion	All Reporting State Nonmember Banks
1984	4.12	0.08	0.07	1.59

---

[1] All figures are weighted averages.

[2] For banks with assets less than $300 million, only those with agricultural loans greater than five percent of total loans reported these data.

Source: Call Report.

Question 10

Table 32

Nonperforming Foreign Office Loans as a Percentage of Equity and Loan Loss Reserves[1/]

State Member Banks With Foreign Offices

As of Year-End	
1984	17.73
1983	9.21
1982	7.71

[1/] Nonperforming foreign office loans are defined as foreign office loans past due 90 days or more and still accruing, and nonaccrual loans and renegotiated foreign office loans. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Source: Call Report.

Question 10

Table 33

Nonperforming Foreign Office Loans as a Percentage of Equity and Loan Loss Reserves[1/]

National Banks With Foreign Offices

As of Year-End	
1984	16.53
1983	13.44
1982	11.52

[1/] Nonperforming foreign office loans are defined as foreign office loans past due 90 days or more and still accruing, and nonaccrual loans and renegotiated foreign office loans. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Source: Call Report.

Question 10

Table 34

Nonperforming Foreign Office Loans as a Percentage of Equity and Loan Loss Reserves[1/]

State Nonmember Banks With Foreign Offices

As of Year-End	
1984	6.00
1983	3.71
1982	3.90

[1/] Nonperforming foreign office loans are defined as foreign office loans past due 90 days or more and still accruing, and nonaccrual loans and renegotiated foreign office loans. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Source: Call Report.

Question 10

Table 35

International Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

State Member Banks With Foreign Offices

1984	1.08
1983	1.83
1982	0.89
1981	0.37
1980	0.15
1979	0.44
1978	0.47

1/ International loans as defined as commercial and industrial loans to non-U.S. addressees, loans to foreign banks, and loans to foreign governments and official institutions. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Source: Call Report.

Question 10

Table 38

International Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

National Banks with Foreign Offices	
1984	2.05
1983	1.94
1982	1.20
1981	0.61
1980	0.57
1979	0.45
1978	0.60

---

[1] International loans as defined as commercial and industrial loans to non-U.S. addressees, loans to foreign banks, and loans to foreign governments and official institutions. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Source: Call Report.

Question 10

Table 37

International Loan Net Charge-Offs as a Percentage of Equity and Loan Loss Reserves[1]

State Nonmember Banks With Foreign Offices

1984	1.05
1983	2.21
1982	1.61
1981	2.13
1980	0.03
1979	(0.23)
1978	0.03

---

[1] International loans as defined as commercial and industrial loans to non-U.S. addressees, loans to foreign banks, and loans to foreign governments and official institutions. No size classes were used as virtually all of these banks exceed $1 billion in assets. All figures are weighted averages.

Numbers in parentheses represent net recoveries.

Source: Call Report.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington D.C. 20429

OFFICE OF THE CHAIRMAN

September 6, 1985

Honorable Fernand J. St Germain
Chairman
Committee on Banking, Finance
and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

In response to your letter of August 1, I am enclosing the bank data information you requested. Interagency meetings have been held to assure that the information is presented on a consistent basis. Agreement was also reached with your staff relative to the format of the information submitted.

If you have any questions concerning the enclosed material, please do not hesitate to contact me or have a member of your staff contact Assistant Director George J. Masa at 389-4141.

Sincerely,

William M. Isaac
Chairman

Enclosure

Federal Deposit Insurance Corporation

Response to Letter dated August 1, 1985 from

U.S. House of Representatives

Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
of the

Committee on Banking, Finance and Urban Affairs

- Please note in regards to item numbers 1 and 2 of the August 1 letter that the FDIC has responded for the Federal Reserve Board and the Comptroller of the Currency.

- In regards to item number 7 of the August 1 letter, the Comptroller of the Currency is providing data on loans classified due to transfer risk for all insured commercial banks. In addition, the Federal Reserve Board is providing data on classified energy loans and real estate loans for all insured commercial banks as well as data on nonperforming loans and net charge-offs in the real estate, agricultural, and international areas.

- In regards to item number 8 of the August 1 letter, the FDIC is providing aggregate year end brokered deposits data for year end 1983 and 1984 for the Federal Reserve Board and Comptroller of the Currency.

1. Number and total deposits of problem organizations (i.e., organizations rated a composite 4 or 5 under the Uniform Financial Institutions Rating System).

TOTAL NUMBER OF FDIC-INSURED PROBLEM COMMERCIAL BANKS AND THRIFTS AND AGGREGATE TOTAL DEPOSITS BY YEAR

Year End	0 - $300 Million	Over $300 Million	Total Number of Problem Banks and Thrifts	Percent of Total Banks and Thrifts
1984	778	70	848	5.8
1983	591	51	642	4.4
1982	332	37	369	2.5
1981	197	26	223	1.5
1980	206	11	217	1.5
1979	274	13	287	2.0
1978	322	20	342	2.3
1977	348	20	368	2.5
1976	361	18	379	2.6
1975	305*	7*	349	2.4

Year End	Total Deposits of Problem Banks and Thrifts (In Millions)	Percent of Total Deposits	Average Size of Problem Banks and Thrifts (In Millions)
1984	186,109	10.3	219
1983	129,081	7.6	201
1982	57,338	3.7	155
1981	42,564	3.0	191
1980	21,644	1.6	100
1979	20,317	1.7	71
1978	64,142	5.6	188
1977	61,904	5.9	168
1976	59,153	6.3	156
1975	20,443	2.3	59

*As of September 1975

Source: Examination Reports

1. Continued

ANNUAL DELETIONS FROM PROBLEM BANK LIST

Year	Bank Failures	Banks Removed from the Problem Bank List Due to Improved Condition (Includes Voluntary Mergers)	Total
1984	79	217	296
1983	48	101	149
1982	42	83	125
1981	10	117	127
1980	10	184	194
1979	10	188	198
1978	7	188	195
1977	6	170	176
1976	16	142	158
1975	13	85	98

Source: FDIC

2. Number and total assets of organizations that failed or were absorbed to avert failure.

All Insured Banks
(Size Categories by Total Assets)
(000)

Year	#	Under $300 Million	#	$300 Million - $1 Billion	#	Over $1 Billion	#	Total
*1984	77	2,638,672	2	905,156	0		79	3,543,828
1983	44	2,321,643	2	1,114,502	2	4,047,489	48	7,483,634
1982	33	962,032	5	3,156,389	4	7,700,000	42	11,818,421
1981	7	109,333	1	900,000	2	3,900,000	10	4,909,333
**1980	10	245,874	0		0		10	245,874
1979	10	141,642	0		0		10	141,642
1978	6	279,729	1	712,500	0		7	992,229
1977	6	232,608	0		0		6	232,608
1976	15	627,149	1	412,107	0		16	1,039,256
1975	13	418,574	0		0		13	418,574
1974	3	166,934	0		1	3,655,662	4	3,822,596
1973	5	43,806	0		1	1,265,868	6	1,309,674
1972	1	22,054	0		0		1	22,054
1971	6	196,518	0		0		6	196,518
1970	7	62,107	0		0		7	62,107

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*Excludes Continental Illinois National Bank.
**Excludes First Pennsylvania Bank, N.A.

Source: Examination Reports.

2. (Continued) Number and total assets of organizations that failed or were absorbed to avert failure.

State Nonmember Commercial Banks
(Size Categories by Total Assets)
(000)

Year	#	Under $300 Million	#	$300 Million - $1 Billion	#	Over $1 Billion	#	Total
1984	54	1,946,513	1	391,780	0		55	2,338,293
1983	32	1,326,162	2	1,114,502	0		34	2,440,664
1982	22	320,238	0		0		22	320,238
1981	4	63,957	0		0		4	63,957
1980	9	233,352	0		0		9	233,352
1979	7	72,804	0		0		7	72,804
1978	5	52,929	1	712,500	0		6	765,429
1977	5	226,342	0		0		5	226,342
1976	13	400,035	0		0		13	400,035
1975	10	189,081	0		0		10	189,081
1974	2	150,639	0		0		2	150,639
1973	3	29,207	0		0		3	29,207
1972	1	22,054	0		0		1	22,054
1971	5	195,217	0		0		5	195,217
1970	6	40,691	0		0		6	40,691

Source: Examination Reports.

2. (Continued) Number and total assets of organizations that failed or were absorbed to avert failure.

Mutual Savings Banks
(Size Categories by Total Assets)
(000)

Year	#	Under $300 Million	#	$300 Million - $1 Billion	#	Over $1 Billion	#	Total
1984	0		1	513,376	0		1	513,376
1983	2	401,324	0		1	2,500,000	3	2,901,324
1982	1	55,250	3	2,170,305	4	7,700,000	8	9,925,555
1981	0		1	900,000	2	3,900,000	3	4,800,000

Note: No mutual savings banks failed or were absorbed to avert failure during the 1970-1980 period.

Source: Examination Reports.

2. (Continued) Number and total assets of organizations that failed or were absorbed to avert failure.

National Banks
(Size Categories by Total Assets)
(000)

Year	#	Under $300 Million	#	$300 Million - $1 Billion	#	Over $1 Billion	#	Total
*1984	17	555,054	0		0		17	555,054
1983	8	406,666	0		1	1,547,489	9	1,954,155
1982	8	318,431	2	986,084	0		10	1,304,515
1981	1	10,566	0		0		1	10,566
**1980	1	12,522	0		0		1	12,522
1979	3	68,838	0		0		3	68,838
1978	1	226,800	0		0		1	226,800
1977	1	6,266	0		0		1	6,266
1976	1	2,612	1	412,107	0		2	414,719
1975	2	155,139	0		0		2	155,139
1974	0		0		1	3,655,662	1	3,655,662
1973	2	14,599	0		1	1,265,868	3	1,280,467
1972	0		0		0		0	
1971	1	1,301	0		0		1	1,301
1970	1	21,416	0		0		1	21,416

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*Excludes Continental Illinois National Bank.
**Excludes First Pennsylvania Bank, N.A.

Source: Examination Reports.

2. (Continued) Number and total assets of organizations that failed or were absorbed to avert failure.

State Member Commercial Banks
(Size Categories by Total Assets)
(000)

Year	#	Under $300 Million	#	$300 Million - $1 Billion	#	Over $1 Billion	#	Total
1984	6	137,105	0		0		6	137,105
1983	2	187,491	0		0		2	187,491
1982	2	268,113	0		0		2	268,113
1981	2	34,810	0		0		2	34,810
1980	0		0		0		0	
1979	0		0		0		0	
1978	0		0		0		0	
1977	0		0		0		0	
1976	1	224,502	0		0		1	224,502
1975	1	74,354	0		0		1	74,354
1974	1	16,295	0		0		1	16,295
1973	0		0		0		0	
1972	0		0		0		0	
1971	0		0		0		0	
1970	0		0		0		0	

Source: Examination Reports.

3(a). Primary capital as a percent of total assets (data from Call Reports)

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total	All Insured Commercial Banks
1984	8.74%	7.48%	6.46%	8.10%	5.89%
1983	8.70	7.25	6.17	8.02	6.66
1982	8.78	7.30	6.10	8.12	6.48
1981	8.74	7.21	5.94	8.09	6.39
1980	8.71	7.26	5.77	8.08	6.34
1979	8.53	6.94	5.82	7.98	6.29
1978	8.32	6.99	5.78	7.87	5.79
1977	8.20	7.05	6.43	7.92	6.17
1976	8.33	7.34	6.57	8.10	6.65
1975	8.26	7.46	6.76	8.07	6.42
1974	8.26	7.38	6.96	8.09	6.21
1973	7.96	7.12	6.66	7.81	N.A.
1972	7.88	7.15	5.81	7.75	N.A.
1971	8.17	7.41	6.06	8.06	N.A.
1970	8.46	7.57	6.14	8.36	N.A.

Definition: Aggregate year-end net worth plus allowance for possible loan losses divided by aggregate year-end total assets for all banks in each size category.

Source: Call Reports.

3(a). Continued

Mutual Savings Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	6.71%	6.17%	4.43%	5.30%
1983	6.49	5.87	4.20	4.92
1982	6.44	5.90	4.02	4.89
1981	6.82	6.15	4.76	5.45
1980	7.35	6.88	5.87	5.36
1979	7.54	7.10	6.47	6.81
1978	7.28	6.72	6.21	6.53
1977	6.98	6.73	6.00	6.40
1976	6.93	6.72	6.05	6.42
1975	7.04	6.80	6.40	6.66
1974	7.32	7.05	6.72	6.96
1973	7.19	6.93	6.69	6.88
1972	7.17	6.78	6.48	6.74
1971	7.35	6.89	6.72	6.94
1970	N.A	N.A	N.A	7.35

Definition: Aggregate year-end net worth plus allowance for possible loan losses divided by aggregate year-end total assets for all banks in each size category.

Source: Call Reports.

3(b). Primary capital as a percent of total assets (data from Examination Reports)

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	8.92%	7.66%	6.53%	8.26%
1983	9.02	7.58	6.39	8.33
1982	9.09	7.94	6.63	8.52
1981	9.23	8.06	7.00	8.72
1980	9.09	8.10	7.09	8.67
1979	8.92	7.96	7.25	8.59
1978	8.78	7.96	7.36	8.52
1977	8.82	7.98	7.83	8.63
1976	8.84	8.40	7.83	8.72
1975	8.89	8.28	8.07	8.77
1974	8.75	7.95	7.96	8.61
1973	8.61	8.14	7.97	8.53
1972	8.63	8.46	6.76	8.58
1971	8.93	8.48	7.54	8.86
1970	9.32	8.52	7.89	9.24

Definition: Aggregate equity capital plus allowance for possible loan losses divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

3(b). Continued

Mutual Savings Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	6.52%	6.32%	4.55%	5.37%
1983	6.56	5.79	4.32	4.99
1982	6.66	6.08	3.80	4.84
1981	7.20	6.75	5.53	6.13
1980	7.51	7.04	6.21	6.64
1979	7.51	6.95	6.26	6.65
1978	7.31	6.65	6.20	6.50

Note: Data not available before 1978.

Definition: Aggregate net worth plus allowance for possible loan losses divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

6. Primary capital less 20% of substandard, 50% of doubtful and 100% of loss as a percent of total assets.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	7.96%	6.87%	5.92%	7.39%
1983	8.11	7.49	5.49	7.42
1982	8.30	7.10	5.89	7.74
1981	8.65	7.43	6.45	8.14
1980	8.57	7.51	6.56	8.14
1979	8.44	7.43	6.61	8.09
1978	8.22	7.16	6.65	7.92
1977	8.14	6.81	6.80	7.86
1976	8.05	6.96	6.69	7.83
1975	8.07	6.88	7.19	7.88
1974	8.14	7.04	7.30	7.96
1973	8.13	7.49	7.51	8.03
1972	8.13	7.76	6.11	8.05
1971	8.36	7.57	7.19	8.26
1970	8.74	7.58	7.59	8.63

Definition: Aggregate equity capital plus allowance for possible loan losses less classified assets divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

4. Continued

Mutual Savings Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	6.04%	5.70	3.96%	4.78%
1983	6.13	5.27	3.63	4.38
1982	6.02	5.40	2.96	4.07
1981	6.59	6.03	4.58	5.30
1980	6.84	6.31	5.19	5.75
1979	6.93	6.22	5.32	5.82
1978	6.67	5.76	5.12	5.55

Note: Data not available before 1978

Definition: Aggregate net worth plus allowance for possible loan losses less classified assets divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

5. Primary capital less classified assets (as defined in no. 4) as a percent of total assets plus standby letters of credit.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	7.91%	6.75%	5.73%	7.30%
1983	8.06	6.56	5.36	7.34
1982	8.25	7.00	5.78	7.66
1981	8.59	7.34	6.34	8.07
1980	8.53	7.44	6.47	8.09
1979	8.41	7.37	6.53	8.04
1978	8.19	7.11	6.58	7.88
1977	8.12	6.77	6.71	7.83
1976	7.99	6.93	6.63	7.77
1975	8.07	6.86	7.18	7.87
1974	8.14	7.02	7.28	7.95

Note: Data for commercial banks not available before 1974. Data on standby letters of credit for Mutual Savings Banks not available because data is not collected on Call Reports.

Definition: Aggregate equity capital plus allowance for possible loan losses less classified assets divided by aggregate total assets plus standby letters of credit for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category except standby letters of credit are aggregated from year-end Call Reports. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination reports, except data for standby letters of credit are from the Call Reports.

6(a). Classified assets (as defined in no. 4) as a percent of total assets.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	0.95%	0.79%	0.61%	0.86%
1983	0.91	0.92	0.90	0.91
1982	0.78	0.84	0.73	0.79
1981	0.58	0.63	0.55	0.58
1980	0.51	0.59	0.53	0.53
1979	0.48	0.54	0.64	0.51
1978	0.56	0.79	0.71	0.61
1977	0.68	1.15	1.04	0.77
1976	0.80	1.44	1.14	0.89
1975	0.82	1.40	0.89	0.89
1974	0.61	0.92	0.66	0.65
1973	0.48	0.65	0.46	0.50
1972	0.50	0.70	0.65	0.53
1971	0.56	0.91	0.35	0.60

Note: Data not available for 1970.

Definition: Aggregate classified assets (as defined in no. 4) divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

6(a). Continued

Mutual Savings Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.48%	0.62%	0.60%	0.58%
1983	0.43	0.51	0.69	0.61
1982	0.63	0.69	0.84	0.77
1981	0.61	0.72	0.96	0.84
1980	0.67	0.73	1.02	0.89
1979	0.58	0.73	0.95	0.83
1978	0.64	0.89	1.08	0.95
1977	0.71	1.11	1.25	1.11
1976	0.75	1.24	1.43	1.24
1975	1.00	1.43	1.42	1.34
1974	0.82	1.16	1.45	1.22
1973	0.32	0.50	0.33	0.39

Note: Data not available before 1973.

Definition: Aggregate classified assets (as defined in no. 4) divided by aggregate total assets for all banks in each size category. Figures are aggregated from the latest available examination as of year-end for all banks in each size category. Due to the intermittent nature of exam scheduling the above data do not cover uniform periods and therefore may differ from the data derived from year-end Call Reports.

Source: Examination Reports.

6(b). Nonperforming assets as a percent of total assets.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	1.86%	1.65%	1.60%	1.81%
1983	1.87	2.02	1.76	1.82
1982	1.74	2.14	2.22	1.88

All Insured Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	1.79%	1.54%	1.83%	1.78%
1983	1.66	1.69	2.30	2.03
1982	1.65	1.85	2.40	2.11

Note: Data not available before 1982.

Definition: Nonperforming assets are loans and leases past due 90 days or more and still accruing income, nonaccrual loans, renegotiated troubled debt and other real estate owned. Aggregate year-end nonperforming assets divided by aggregate year-end total assets for all banks in each size category.

Source: Call Reports.

8(a). Purchased funds as a percent of total assets.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	13.66%	22.34%	33.87%	18.97%
1983	12.90	22.25	34.38	18.21
1982	14.93	25.68	39.41	20.46
1981	15.41	28.19	40.66	21.14
1980	13.78	26.65	36.23	18.84
1979	13.00	25.12	33.14	17.10
1978	12.12	22.63	30.58	15.49
1977	10.46	17.16	23.45	12.35
1976	10.08	17.79	23.40	11.91

Note: Data not available before 1976.

Definition: Aggregate year-end volatile liabilities divided by aggregate year-end total assets. Volatile liabilities are time deposits of $100,000 or more plus federal funds purchased and securities sold under agreements to repurchase plus interest-bearing demand notes issued to the U.S. Treasury and other liabilities for borrowed money plus deposits in foreign offices.

Source: Call Reports.

8(b). Brokered deposits as a percent of total deposits.

State Nonmember Commercial Banks

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.21	0.23	4.21	0.90
1983	0.28	0.30	5.19	1.07

Mutual Savings Banks

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.09	0.18	1.64	0.97
1983	0.17	0.00	0.77	0.51

National Banks

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.12	0.21	2.91	1.95
1983	0.19	0.28	2.60	1.72

State Member Banks

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.11	0.11	1.26	0.93
1983	0.16	0.00	1.42	1.06

All Insured Commercial Banks

Year	Under $300 Million	$300 Million- $1 Billion	Over $1 Billion	Total
1984	0.16	0.20	2.64	1.45
1983	0.23	0.21	2.39	1.36

Note: Data not available before 1983.

Definition: Aggregate year-end brokered deposits (i.e., deposits received from brokers or dealers for the account of others either directly or ultimately) divided by aggregate total year-end deposits for all banks in each size category.

Source: Call Reports.

8(a) Net income as a percent of total assets.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total	All Insured Commercial Banks
1984	0.83%	0.80%	0.66%	0.79%	0.63%
1983	0.86	0.70	0.61	0.79	0.64
1982	0.97	0.72	0.62	0.88	0.68
1981	1.06	0.79	0.57	0.94	0.73
1980	1.11	0.91	0.64	1.02	0.75
1979	1.09	0.87	0.70	1.01	0.76
1978	0.98	0.82	0.66	0.92	0.71
1977	0.89	0.62	0.68	0.84	0.66
1976	0.85	0.69	0.67	0.82	0.66
1975	0.82	0.65	0.64	0.79	0.66
1974	0.91	0.82	0.66	0.89	0.68
1973	0.92	0.86	0.57	0.90	0.78
1972	0.84	0.83	0.57	0.84	0.77
1971	0.89	0.89	0.42	0.88	0.82
1970	0.94	0.94	0.50	0.94	0.84

Definition: Aggregate net income divided by aggregate year-end total assets for all banks in each size category.

Source: Call Reports.

9(a) Net income as a percent of total assets.

Mutual Savings Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total
1984	0.48%	0.30%	-0.18%	0.06%
1983	0.39	0.15	-0.30	-0.10
1982	-0.26	-0.44	-1.10	-0.80
1981	-0.32	-0.65	-1.23	-0.93
1980	0.24	-0.02	-0.35	-0.17
1979	0.54	0.44	0.38	0.44
1978	0.74	0.59	0.50	0.57
1977	0.70	0.53	0.44	0.52
1976	0.61	0.45	0.33	0.42
1975	0.51	0.34	0.27	0.34
1974	0.54	0.36	0.22	0.33
1973	0.63	0.48	0.49	0.51
1972	0.63	0.56	0.49	0.55
1971	0.56	0.45	0.36	0.44
1970	N/A	N/A	N/A	0.24

Definition: Aggregate net income divided by aggregate year-end total assets for all banks in each size category.

Source: Call Reports.

9(b) Net income as a percent of total equity.

State Nonmember Commercial Banks
(Size Categories by Total Assets)

Year	Under $300 Million	$300 Million-$1 Billion	Over $1 Billion	Total	All Insured Commercial Banks
1984	10.20%	11.81%	11.39%	10.61%	10.21%
1983	10.61	10.56	11.00	10.66	10.70
1982	11.85	10.72	11.25	11.63	11.63
1981	12.84	11.94	10.60	12.48	12.51
1980	13.61	13.63	12.16	13.47	13.02
1979	13.64	13.71	13.29	13.62	13.20
1978	12.55	12.81	12.43	12.58	13.57
1977	11.64	9.58	11.44	11.43	11.73
1976	10.87	10.00	11.06	10.82	10.85
1975	11.01	9.92	10.74	10.88	11.29
1974	12.20	12.70	10.77	12.20	12.00
1973	12.85	13.81	9.59	12.85	12.25
1972	11.85	13.22	10.57	12.01	11.71
1971	12.08	13.73	7.51	12.22	11.91
1970	12.42	14.51	8.20	12.55	11.95

Definition: Aggregate net income divided by aggregate year-end total equity for all banks in each size category.

Source: Call Reports.

Federal Home Loan Bank Board

1700 G Street, N.W.
Washington, D.C. 20552
Federal Home Loan Bank System
Federal Home Loan Mortgage Corporation
Federal Savings and Loan Insurance Corporation

EDWIN J. GRAY
CHAIRMAN

September 9, 1985

Honorable Fernand J. St Germain
U.S. House of Representatives
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance of the
Committee on Banking, Finance and Urban Affairs
Washington, D.C. 20515

Dear Mr. Chairman:

In response to your written request of August 1 for statistical information related to savings and loan operations, the Bank Board has gathered the attached data.

As noted in discussions held with members of your staff, the information dates back to 1980, which is the earliest period for which our records are computerized. Any information gathered for the years prior to 1980 would involve an extensive manual collection and analysis of written records. There are certain distortions between statistics collected pre- and post-1980. Your office staff has informed us that any pre-1980 statistics the sub-committee may be taken from printed volumes of the "Third meeting on the condition of the Financial System", which encompass hearings before the Proxmire committee completed May 23, 1979. Information submitted to the committee from the Board at that time covered institutions in problem book categories. Though the problem book no longer exists, your staff indicated the acceptability of this information.

Additionally, please note that in response to item #10 of your August 1 letter, we have chosen to submit information on problems encountered with state-chartered institutions and their direct investment programs. We feel such information is basic to the Subcommittee's understanding of the current status of savings institutions' financial condition.

Sincerely,

Edwin J. Gray

Attachments

1. Number of problem organizations.

Year	Institution Size Small	Medium	Large	Total
1984	755	180	89	1,024
1983	691	136	68	895
1982	643	102	53	798
1981	458	63	23	544
1980	142	12	5	159

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Problem organizations - Institutions rated "4" and "5" as of year-end.

Source

ETWRS - Examination Tracking and Workload Reporting System for the FHLBB.

2. Number and total assets of organizations failed or absorbed to avert failure.

	Institution Size*					
	Small		Medium		Large	
Year	Assets	No	Assets	No	Assets	No
1984	$3,031,473	45	$3,470,210	6	$7,975,178	3
1983	$6,116,716	86	$3,837,776	8	$ 0	0
1982	$17,027,986	220	$12,341,161	26	$4,901,786	4
1981	$4,607,583	82	$2,932,614	5	$7,363,699	4

	Supervisory		Assisted***	
	Assets	No	Assets	No
1980**	$1,157,000	21	$1,421,000	11

* Data includes institutions merged with FSLIC assistance.

** 1980 data not available by asset classes or examination rating.

*** Mergers in which FSLIC assistance was necessary.

Definitions

Total assets - as of year-end prior to merger date in thousands.

Small - Less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - More than $1 billion in assets.

Sources

For number of institutions - ETWRS - Examination Tracking and Workload Reporting System for the FHLBB.

For year-end asset figures - Semiannual FHLBB report data.

3. Primary capital as a percent of total assets.
Goodwill and other intangibles as a percent of total assets.

	Primary Capital to Total Assets Institution Size			Goodwill and other Intangibles to Total Assets: All Institutions
Year	Small	Medium	Large	
1984	3.99%	3.36%	3.22%	2.45%
1983	4.02%	3.50%	3.62%	2.70%
1982	4.22%	3.25%	3.11%	2.41%
1981	6.92%	4.03%	3.99%	0.27%
1980	5.78%	5.03%	5.08%	0.03%

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary capital - net worth minus qualifying subordinated debentures, net worth certificates, income capital certificates and appraised equity capital.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

4. Primary capital less classified assets as a percent of total assets.

	Institution Size		
Year	Small	Medium	Large
1984	3.66%	3.10%	2.99%
1983	3.64%	3.18%	3.34%
1982	3.87%	2.94%	2.82%
1981	4.67%	3.81%	3.79%
1980	5.57%	4.86%	4.95%

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - more than $1 billion in assets.

Primary capital - net worth minus qualifying subordinated debentures, net worth certificates, income capital certificates and appraised equity capital.

Classified Assets - 20 percent of scheduled items, the latter as defined in Section 561.15 of the Rules and Regulations for the FSLIC.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

5. Primary capital less classified assets as a percent of total assets including standby letters of credit and other off-balance sheet items.

   This information is not provided since the Board does not collect data relative to separate statistics on standby letters of credit or other off-balance sheet items.

6. Classified assets and nonperforming assets as a percent of total assets.

	Institution Size		
Year	Small	Medium	Large
1984	0.33%	0.25%	0.23%
1983	0.38%	0.32%	0.28%
1982	0.35%	0.31%	0.29%
1981	0.25%	0.22%	0.20%
1980	0.21%	0.17%	0.13%

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - More than $1 billion in assets.

Classified assets - 20 percent of scheduled items, the latter as defined in Section 561.15 of the Rules and Regulations for the FSLIC. Nonperforming assets are included in the definition of scheduled items.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

7. Classified and nonperforming energy loans, agricultural loans, international loans and real estate development loans and investments, each as a percent of primary capital.

	Institution Size		
Year	Small	Medium	Large
1984	8.27%	7.37%	7.14%
1983	9.40%	9.03%	7.85%
1982	8.29%	9.54%	9.39%
1981	5.04%	5.56%	5.01%
1980	3.67%	3.42%	2.48%

Definitions

Small - less than $300 million in assets.

Medium - $300 million to $1 billion in assets.

Large - More than $1 billion in assets.

Classified and nonperforming loans of each type - 20 percent of scheduled items, the latter as defined in Section 561.15 of the Rules and Regulations for the FSLIC. Loan types are not separately presented as a percent of primary capital because data on energy, agricultural and international loans is not individually collected. Such loans, if authorized, would be placed in a general commercial loan category.

Primary Capital - net worth minus qualifying subordinated debentures, net worth certificates, income capital certificates and appraised equity capital.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

8. Purchased funds and brokered deposits, each as a percent of total assets.

Year	Brokered Deposits*	Other Borrowings	Jumbo Deposits*
1984	4.27%	6.70%	11.40 %
1983	3.65%	4.20%	9.84%
1982	1.19%	4.14%	8.09%
1981	0.51%	3.39%	7.42%
1980	0.64%	2.02%	6.57%

* Jumbo deposits may include brokered deposits as conversely, brokered deposits may include jumbo deposits.

Definitions

Other Borrowings - Borrowings from all sources other than a FHLBank including commercial bank loans, reverse repurchase agreements, consumer retail repurchase agreements, overdrafts in demand deposits, commercial paper issued, subordinated debentures not qualifying for net worth and mortgage-backed bonds issued.

Jumbo Deposits - Deposits and Certificate Accounts with balances in excess of $100,000 for the year 1984; with balances of $100,000 or more for the years 1980 - 1983.

Sources

1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

9. Net income as a percent of equity capital and/or assets: return on assets (ROA) for all institutions; return on equity (ROE) for stock institutions.

Year	Aggregate ROA	Aggregate ROE
1984	0.20%	5.717%*
1983	0.27%	13.288%
1982	(0.65)%	(10.485)%
1981	(0.73)%	(14.474)%
1980	0.13%	4.809%
1979	0.67%	
1978	0.82%	
1977	0.77%	
1976	0.63%	
1975	0.47%	
1974	0.54%	
1973	0.76%	
1972	0.77%	
1971	0.71%	
1970	0.57%	

Definitions

ROA - net income as a percent of average assets.

ROE - net income as a percent of ending net worth, except in 1984 where net income is a percent of beginning net worth. * 1984 ROE is an average of 2nd, 3rd and 4th quarters only.

Source

For ROA - Office of Policy and Economic Research (OPER) - 1984 Savings and Home Financing Source Book.

For ROE - 1980 - 1983 - Semiannual FHLBB report data.
1984 - Quarterly FHLBB report data.

10. Any other information that would augment the Subcommittee's understanding of the current status of the financial condition generally of depository institutions.

The Board chooses to discuss problems related to direct investments, most especially those made by state-chartered institutions, as such problems are reflective of the pervasive ills affecting the Industry.

Thrift failures in 1984 due to asset quality problems represented 70 percent of total failures. To date in 1985, all 17 FSLIC failures were directly attributable to such problems. The cost of resolving these cases has proved costlier than those involving failure due to interest rate spread problems. In 1984, assistance for asset related failures amounted to 27 percent of total assets of failed thrifts compared to 3 percent for spread related failures. Unfortunately, a forecast of troubled institutions shows that the asset quality failure trend (and therefore the trend towards increased assistance) is continuing.

The penchant of many thrifts toward rapid growth and direct investments has resulted in many unsound investments in speculative assets which inevitably leads to a greater potential for loss. Nowhere is this hazardous phenomenon more apparent than among state-chartered institutions in California and Texas. Broader state charter authority has enabled these institutions to undertake much greater risks through enhanced product and service authorities which far exceed those allowed federally chartered thrifts.

Texas has legislated powers to state-chartered thrifts that include:

1. Powers to make land development loans.

2. Powers to invest in corporate bonds and securities.

3. Broad service corporation investment authority.

4. Broad powers to acquire, subdivide and develop real property for residential and other purposes.

California has completely deregulated the asset powers of state-chartered thrifts. Up to 100% of a California institution's assets may be invested in real estate or in a service corporation. Such leeway has, among others, led to investments in windmill farms, corporate and equity securities, junk bonds and large scale real estate development projects.

An analysis of state chartered institutions in Texas, which are current FSLIC cases or which are projected as FSLIC assistance cases requiring assistance within twelve months reveals that 71 percent of these cases can be directly associated with the abuse and misuse of the direct investment authority.

The most common abuse committed by these institutions has been the investment of a substantial portion of their resources in the organization of, or participation in, loans, for the acquisition and development of real estate, including the construction of improvements thereon. In most cases the loans were based on appraisals predicated on "land-flips". Generally the loans or investments portrayed one or more of the following high risk characteristics:

> The lender assumed virtually all of the risk by providing all, or substantially all, of the funds while the borrower, although legally holding title, had little or no equity in the property.
>
> The transaction was structured to maximize front-end profit recognition through the charging of commitment and/or other loan fees which were actually funded by the lender.
>
> Accrued interest was funded by the lender and was recognized as income throughout the term of the project.
>
> Either no arrangements for permanent take-out financing were made or the lender agreed but verbally to convert the loan into some type of permanent financing upon completion of construction.
>
> The lender was a profit participant, usually on a percentage basis, and upon the sale of the project perhaps realized an equity kicker.

The funds for all or a material portion of these loans were obtained from brokered or jumbo savings. In one case, a large state-chartered institution loaned $700 MM for construction projects with the aforementioned high risk characteristics, which were funded by wholesale funds. Of this aggregate total, 70 percent are currently scheduled items or non-performing assets.

There are currently eight California thrift institutions which are FSLIC cases and ten which are projected to be FSLIC cases within 12 months. Of these institutions, at least 15 may be cited for asset quality problems. Most entered into transactions involving speculative construction and real estate development projects which shared the same high-risk characteristics as those described above in the discussion of poor lending practices by Texas thrifts. These institutions, like those in Texas, also placed considerable reliance upon brokered or jumbo savings to fund their projects.

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

September 6, 1985

Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
Committee on Banking, Finance and Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

The data that you requested for national banks in your letter of August 1, 1985 are enclosed for your information. The time series of the data, the size categories of national banks, and the data definitions are as agreed upon with your staff.

We are pleased to provide you with this information.

Sincerely,

H. Joe Selby
Acting Comptroller of the Currency

Enclosure

Office of the Comptroller of the Currency

Response to Letter dated August 1, 1985 from
U.S. House of Representatives
Subcommittee on Financial Institutions
Supervision, Regulation and Insurance
of the
Committee on Banking, Finance and Urban Affairs

Question 1.

NUMBER AND TOTAL ASSETS OF "PROBLEM ORGANIZATIONS."

Data to be provided by the Federal Deposit Insurance Corporation.

Question 2

NUMBER AND ASSETS OF NATIONAL BANKS FAILED OR ABSORBED TO AVERT FAILURE

National Banks
(Size Categories by Total Assets)
($ millions)

	Under $300 million		$300 million-$1 billion		Over $1 billion		Total	
Year	#	Assets	#	Assets	#	Assets	#	Assets
1984	17	$555.1	0	-	0	-	17	$555.1
1983	8	406.7	0	-	1	$1,547.5	9	1,954.2
1982	8	318.4	2	986.1	0	-	10	1,304.5
1981	1	10.6	0	-	0	-	1	10.6
1980	1	12.5	0	-	0	-	1	12.5
1979	3	68.8	0	-	0	-	3	68.8
1978	1	226.8	0	-	0	-	1	226.8
1977	1	6.3	0	-	0	-	1	6.3
1976	1	2.6	1	412.1	0	-	2	417.7
1975	2	155.1	0	-	0	-	2	155.1
1974	0	-	0	-	1	3,655.6	1	3,655.7
1973	2	14.6	0	-	1	1,265.9	3	1,280.5
1972	0	-	0	-	0	-	0	-
1971	1	1.3	0	-	0	-	1	1.3
1970	1	21.4	0	-	0	-	1	21.4

Hyphen indicates data not available.

Source: FDIC, Reports of Examination.

Question 3

PRIMARY CAPITAL AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	8.59%	7.46%	6.05%	6.62%
1983	8.50	7.40	5.66	6.34
1982	8.53	7.36	5.37	6.13
1981	8.50	7.32	5.22	6.03
1980	8.44	7.33	5.18	6.02
1979	8.27	7.12	5.18	6.00
1978	8.09	7.00	5.23	6.05
1977	7.91	7.07	5.34	6.15
1976	8.08	7.14	5.56	6.39
1975	8.06	7.29	5.55	6.42
1974	8.06	7.10	5.19	6.16
1973	7.81	6.98	5.38	6.24
1972	7.71	7.21	5.90	6.62
1971	7.93	7.66	6.42	7.07
1970	8.22	8.00	6.74	7.41

Definition: Aggregate year-end primary capital (total equity capital + allowance for loan and lease losses for 1976-1984, reserves on loans for 1970-1975) divided by aggregate year-end total assets.

Source: Call Reports.

Question 3

PRIMARY CAPITAL (AS OF EXAMINATION DATE)
AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	8.66%	7.42%	5.73%	6.45%
1983	8.60	7.42	5.65	6.37
1982	8.66	7.45	5.32	6.15
1981	8.65	7.55	5.20	6.10
1980	8.55	7.47	5.12	6.03
1979	8.38	7.34	5.21	6.07
1978	7.76	6.92	4.97	5.83
1977	7.66	6.94	4.97	5.82
1976	7.54	6.77	4.77	5.81
1975	7.56	6.69	4.77	5.76
1974	7.38	6.44	4.68	5.62
1973	7.33	6.80	5.29	6.11
1972	7.52	7.37	6.16	6.77
1971	7.70	7.54	6.23	6.91
1970	7.98	8.04	6.81	7.43

Note: The data used to calculate these ratios were obtained from examination reports rather than call reports. As a result of the intermittent nature of exam scheduling among banks, these data do not cover uniform periods. Therefore the data may differ from statistics obtained from year-end call reports.

Definition: Aggregate primary capital at examination date (gross capital funds - subordinated debt 1979-1984, total equity + reserves on loans 1970-1978) divided by aggregate total assets.

Source: 1979-1984, OCC.
1970-1978, FRB.

Question 4

PRIMARY CAPITAL (AS OF EXAMINATION DATE) LESS CLASSIFIED ASSETS, AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	7.80%	6.73%	4.44%	5.29%
1983	7.84	6.65	4.34	5.21
1982	7.99	6.69	4.34	5.25
1981	8.15	7.04	4.57	5.95
1980	8.10	7.03	4.58	5.50
1979	8.00	6.95	4.61	5.54
1978	7.36	6.41	4.20	5.17
1977	7.22	6.29	4.02	5.02
1976	7.04	5.96	3.27	4.68
1975	7.08	5.85	3.28	4.62
1974	7.05	5.94	3.85	4.96
1973	7.09	6.46	4.75	5.69
1972	7.26	6.92	5.61	6.32
1971	7.40	7.10	5.64	6.44
1970	7.66	7.63	6.39	7.05

Note: The data used to calculate these ratios were obtained from examination reports rather than call reports. As a result of the intermittent nature of exam scheduling among banks, these data do not cover uniform periods. Therefore the data may differ from statistics obtained from year-end call reports.

Definition: Aggregate primary capital at examination date (gross capital funds - subordinated debt 1979-1984, total equity + reserves on loans 1970-1978) minus aggregate classified assets (20% of substandard + 50% of doubtful + 100% of loss) divided by aggregate total assets.

Source: 1979-1984, OCC.
1970-1978, FRB.

Question 5

PRIMARY CAPITAL (AS OF EXAMINATION DATE)
LESS CLASSIFIED ASSETS, AS A PERCENT OF
TOTAL ASSETS INCLUDING STANDBY LETTERS OF CREDIT

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	7.75%	6.64%	4.17%	5.05%
1983	7.75	6.55	4.08	4.98
1982	7.95	6.59	4.11	5.04
1981	8.12	6.96	4.37	5.31
1980	8.08	6.96	4.43	5.36
1979	7.98	6.90	4.48	5.43
1978	7.36	6.40	4.20	5.17
1977	7.21	6.27	4.01	5.01
1976	7.02	5.91	3.17	4.59
1975	7.07	5.80	3.15	4.50
1974	7.03	5.88	3.71	4.84

Note: The data used to calculate these ratios were obtained from examination reports rather than call reports. As a result of the intermittent nature of exam scheduling among banks, these data do not cover uniform periods. Therefore the data may differ from statistics obtained from year-end call reports.

Standby letters of credit were not reported before 1974.

Definition: Aggregate primary capital at examination date (gross capital funds - subordinated debt 1979-1984, total equity + reserves on loans 1974-1978) minus aggregate classified assets (20% of substandard + 50% of doubtful + 100% of loss), divided by aggregate total assets plus standby letters of credit.

Source: 1979-1984, OCC.
1970-1978, FRB.

Question 6

CLASSIFIED ASSETS (AS OF EXAMINATION DATE) AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	0.86%	0.69%	1.29%	1.15%
1983	0.77	0.78	1.31	1.16
1982	0.67	0.76	0.98	0.90
1981	0.50	0.50	0.63	0.60
1980	0.45	0.44	0.53	0.51
1979	0.38	0.39	0.60	0.53
1978	0.40	0.51	0.77	0.66
1977	0.44	0.65	0.95	0.80
1976	0.50	0.81	1.50	1.13
1975	0.47	0.84	1.49	1.14
1974	0.33	0.49	0.83	0.65
1973	0.24	0.34	0.54	0.42
1972	0.26	0.45	0.55	0.44
1971	0.30	0.44	0.59	0.47
1970	0.32	0.41	0.41	0.38

Note: The data used to calculate these ratios were obtained from examination reports rather than call reports. As a result of the intermittent nature of exam scheduling among banks, these data do not cover uniform periods. Therefore the data may differ from statistics obtained from year-end call reports.

Definition: Aggregate classified assets (20% of substandard + 50% of doubtful + 100% of loss), divided by aggregate total assets.

Source: 1979-1984, OCC.
1970-1978, FRB.

Question 6

NONPERFORMING ASSETS AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	1.72%	1.54%	2.42%	2.22%
1983	1.51	1.55	2.58	2.29
1982	1.51	1.74	2.48	2.23

Definitions: Aggregate year-end nonperforming assets divided by aggregate year-end total assets for all banks in category.

Nonperforming Assets = loans and leases past due 90 days or more and still accruing + nonaccrual loans and leases + renegotiated loans and leases + real estate owned other than bank premises.

Source: Call Reports.

Question 7

CLASSIFIED ENERGY LOANS AS A PERCENTAGE OF EQUITY PLUS LOAN LOSS RESERVES

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	.41%	1.03%	3.22%	3.13%
1983	.35	.87	2.85	2.73
1982	.01	.07	.63	.59
1981	0	0	.40	.37
1980	0	0	.12	.11
1979	.06	.08	.28	.27
1978	0	.01	.43	.40
1977	0	.01	.24	.22

Definition: Aggregate year-end classified energy loans in the Shared National Credit Program (20% substandard + 50% doubtful + 100% loss) divided by aggregate year-end total equity + loan loss reserves from previous June Call Report.

Source: FRB, Shared National Credit Program.

Question 7

NONPERFORMING AGRICULTURAL LOANS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

Reporting National Banks With Assets Over $100 Million
(Size Categories by Total Assets)

Year	$100 million-$300 million	$300 million-$1 billion	Over $1 billion	Total
1984	8.55%	2.43%	2.49%	2.85%
1983	3.93	2.52	2.85	2.91
1982	3.23	2.82	2.31	2.44

Note: In 1982 and 1983 only banks with agricultural loans greater than 1% of domestic office loans reported these data. In 1984 the threshold was raised to 5%.

Definitions: Aggregate year-end nonperforming agricultural loans divided by aggregate year-end total equity + loan loss reserves.

Nonperforming agricultural loans = agricultural loans past due 90 days or more and still accruing + nonaccrual agricultural loans + renegotiated agricultural loans.

Source: FRB, Call Reports.

Question 7

AGRICULTURAL NET CHARGE-OFFS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

Reporting National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	4.01%	0.31%	0.49%	0.71%

Note: For banks under $300 million, only those with agricultural loans greater than 5% of total domestic loans reported these data.

Definition: Aggregate year-end agricultural net charge-offs divided by aggregate year-end total equity + loan loss reserves.

Source: FRB, Call Reports.

Question 7

INTERAGENCY COUNTRY EXPOSURE REVIEW COMMITTEE (ICERC) CLASSIFIED ASSETS AS A PERCENTAGE OF PRIMARY CAPITAL

Year	National Banks	State Member Banks	State Nonmember Banks	Total
1984	1.78%	1.96%	1.13%	1.80%
1983	3.26	4.45	1.05	3.46
1982	2.74	3.82	1.21	2.95

Definition: Aggregate ICERC classified assets (20% of substandard + 50% of value impaired) divided by aggregate primary capital for all banks with ICERC classified assets.

Source: OCC.

Question 7

NONPERFORMING FOREIGN OFFICE LOANS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

National Banks With Foreign Offices

Year	Total
1984	16.53%
1983	13.44
1982	11.52

Note: No size categories were used because virtually all banks exceed $1 billion in assets.

Definitions: Aggregate year-end nonperforming foreign office loans divided by aggregate year-end total equity + loan loss reserves.

Nonperforming foreign office loans = foreign office loans past due 90 days or more and still accruing + nonaccrual foreign office loans + renegotiated foreign office loans.

Source: FRB, Call Reports.

Question 7

INTERNATIONAL LOAN NET CHARGE-OFFS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

National Banks With Foreign Offices

Year	Total
1984	2.05%
1983	1.94
1982	1.20
1981	0.61
1980	0.57
1979	0.45
1978	0.60

Note: No size categories were used because virtually all banks exceed $1 billion in assets.

Definitions: Aggregate year-end international net loan charge-offs divided by aggregate year-end total equity + loan loss reserves.

International loans = commercial and industrial loans to non-U.S. addressees + loans to foreign banks + loans to foreign governments and official institutions.

Source: FRB, Call Reports.

Question 7

CLASSIFIED REAL ESTATE LOANS AS A PERCENTAGE OF EQUITY PLUS LOAN LOSS RESERVES

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	.02%	.03%	.34%	.33%
1983	.01	.02	.16	.15
1982	.02	.06	.08	.08
1981	.04	.02	.16	.16
1980	.24	.22	.24	.23
1979	.92	.18	.19	.19
1978	.79	.19	.39	.39
1977	.66	.29	.66	.63

Definition: Aggregate year-end classified real estate loans in the Shared National Credit Program (20% substandard + 50% doubtful + 100% loss) divided by aggregate year-end total equity + loan loss reserves from previous June Call Report.

Source: FRB, Shared National Credit Program.

Question 7

NONPERFORMING REAL ESTATE LOANS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

National Banks With Assets Over $100 Million
(Size Categories by Total Assets)

Year	$100 million- $300 million	$300 million- $1 billion	Over $1 billion	Total
1984	5.15%	5.17%	6.40%	6.14%
1983	5.02	4.87	7.18	6.64
1982	5.94	6.57	9.54	8.73

Definitions: Aggregate year-end nonperforming real estate loans divided by aggregate year-end total equity + loan loss reserves.

Nonperforming real estate loans = real estate loans past due 90 days or more and still accruing + nonaccrual real estate loans + renegotiated real estate loans.

Source: FRB, Call Reports.

Question 7

REAL ESTATE LOAN NET CHARGE-OFFS AS A PERCENTAGE OF EQUITY AND LOAN LOSS RESERVES

National Banks With Assets Over $300 Million
(Size Categories by Total Assets)

Year	$300 million- $1 billion	Over $1 billion	Total
1984	0.33%	0.60%	0.57%
1983	0.31	0.36	0.36
1982	0.34	0.21	0.23
1981	0.17	0.11	0.12
1980	0.08	0.07	0.07
1979	0.19	0.22	0.22
1978	0.33	0.65	0.60
1977	0.53	0.69	0.66
1976	0.87	1.03	1.00

Definition: Aggregate year-end real estate loan net charge-offs divided by aggregate year-end total equity + loan loss reserves.

Source: FRB, Call Reports.

Question 8

VOLATILE LIABILITIES AS A PERCENTAGE OF TOTAL ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	14.58%	21.55%	44.02%	36.82%
1983	13.56	21.28	47.45	38.99
1982	15.00	26.18	52.51	43.35
1981	15.35	27.11	54.88	45.01
1980	14.30	25.00	54.05	43.68
1979	13.69	24.72	53.54	42.57
1978	13.08	24.78	52.67	41.09
1977	11.24	22.33	50.42	37.93
1976	10.88	21.01	45.70	32.83

Note: Data not available before 1976.

Definitions: Aggregate year-end volatile liabilities divided by aggregate year-end total assets.

Volatile Liabilities = Time Deposits in Denominations of $100,000 or More + Federal Funds Purchased and Securities Sold Under Agreements to Repurchase + Interest Bearing Demand Notes Issued to the U.S. Treasury and Other Liabilities for Borrowed Money (1978-1984), Other Liabilities for Borowed Money (1976-1977) + Total Foreign Deposits.

Source: Call Reports.

Question 8

BROKERED DEPOSITS AS A PERCENTAGE OF TOTAL DEPOSITS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion
1984	0.12%	0.21%	2.91%
1983	0.19	0.28	2.60

Definitions: Aggregate year-end brokered deposits divided by aggregate year-end deposits.

Brokered deposits = deposits received from brokers or dealers for the account of others either directly or ultimately.

Source: FDIC, Call Reports.

Question 9

RETURN ON ASSETS

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	0.77%	0.85%	0.46%	0.55%
1983	0.86	0.76	0.48	0.57
1982	0.91	0.75	0.54	0.63
1981	0.98	0.85	0.58	0.68
1980	1.02	0.86	0.59	0.70
1979	1.00	0.84	0.63	0.73
1978	0.94	0.78	0.60	0.69
1977	0.87	0.71	0.55	0.64
1976	0.85	0.66	0.57	0.65
1975	0.79	0.68	0.59	0.65
1974	0.86	0.71	0.54	0.64
1973	0.87	0.72	0.55	0.66
1972	0.83	0.75	0.58	0.68
1971	0.85	0.81	0.63	0.73
1970	0.89	0.89	0.65	0.76

Definition: Aggregate net income divided by aggregate year-end total assets.

Source: Call Reports.

Question 9

RETURN ON EQUITY

National Banks
(Size Categories by Total Assets)

Year	Under $300 million	$300 million-$1 billion	Over $1 billion	Total
1984	9.69%	12.52%	8.71%	9.32%
1983	10.81	11.28	9.66	10.12
1982	11.43	11.09	11.50	11.44
1981	12.31	12.67	12.54	12.49
1980	12.88	12.75	12.75	12.79
1979	13.01	12.91	13.57	13.33
1978	12.38	12.17	12.66	12.52
1977	11.82	10.90	11.32	11.42
1976	11.19	10.44	11.22	11.10
1975	10.90	10.57	12.39	11.62
1974	11.84	11.37	12.39	12.05
1973	12.43	11.78	12.17	12.20
1972	11.94	11.83	11.50	11.71
1971	11.99	12.07	11.63	11.83
1970	12.14	12.67	11.45	11.90

Definition: Aggregate net income divided by aggregate year-end total equity.

Source: Call Reports.

September 5, 1985

Honorable Fernand J. St Germain
Chairman
Subcommittee on Financial Institutions
  Supervision, Regulation and Insurance
Committee on Banking, Finance and
  Urban Affairs
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman St Germain:

Thank you for your letter of August 1.

Pursuant to that letter and to subsequent discussions with your staff, the National Credit Union Administration is pleased to provide the Subcommittee with the attached data on credit union operations.

Please let us know if we may be of further assistance.

Sincerely,

P. A. MACK, JR.
Vice Chairman

PAM:dl

Enclosure

ITEM #1

NUMBER AND TOTAL DEPOSITS (SHARES) OF "PROBLEM" ORGANIZATIONS

Year	Number	Deposits (Millions)
6/30/85	732	$3,821
1984	872	$4,071
1983	1,124	$4,652
1982	1,192	$4,590
1981	1,174	$2,980
1980	1,018	$2,400
1979	1,020	$2,300
1978	825	$1,450
1977	660	531
1976	830	570

"Problem" organizations are defined as codes 4 and 5 federal credit unions and federally insured state-chartered credit unions

The above data is reported as of fiscal year-end - September 30.

NOTE: All data throughout the report is combined for federally chartered credit unions and for federally insured state-chartered credit unions

ITEM #2

NUMBER AND TOTAL DEPOSITS (SHARES) OF ORGANIZATIONS FAILED OR ABSORBED TO AVERT FAILURE

	Liquidations		Assisted Mergers/ Purchase & Assumptions	
Year	Number	Amount of Shares (Millions)	Number	Amount of Shares (Millions)
6/30/85	26	$11.7	54	$41.8
1984	38	$34.8	100	$190.2
1983	50	$10.0	212	N/A
1982	160	$39.9	182	N/A
1981	251	$78.6	100	N/A
1980	239	$60.0	63	N/A
1979	169	$19.0		
1978	168	$14.2		
1977	142	$12.7		
1976	128	$7.5		
1975	153	$5.5		
1974	100	$2.8		
1973	50	$1.4		
1972	4	$0.002		
1971	0	$0		

Numbers of assisted mergers and purchase and assumptions were not identified separately from unassisted mergers until 1980

The above data is reported as of fiscal year-end - September 30. The data for June 30, 1985, is for a 9-month period.

ITEM #3

PRIMARY CAPITAL AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
6/30/85	6.82
1984	7.07
1983	6.86
1982	7.24
1981	6.98
1980	6.40
1979	6.66
1978	6.25
1977	6.05
1976	6.30
1975	6.56
1974	7.00
1973	8.96
1972	9.23
1971	9.66

As nonprofit cooperatives, credit unions do not have "capital." However, for purposes of this report and in order to be somewhat consistent with the reporting of the other agencies, capital in credit unions is defined as all reserves and retained earnings and does not include shares.

ITEM #4

PRIMARY CAPITAL LESS CLASSIFIED ASSETS AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
6/30/85	6.46
1984	6.68
1983	6.39
1982	6.66
1981	6.40
1980	5.76
1979	6.06
1978	5.78

See the definition of primary capital under item 3. Classified assets are defined as 50 percent of loans 6 to 12 months delinquent and 75 percent of loans in excess of 12 months delinquent. Loan delinquency by age category is not available prior to 1978.

ITEM #5

PRIMARY CAPITAL LESS CLASSIFIED ASSETS AS A PERCENTAGE OF TOTAL ASSETS, INCLUDING STANDBY LETTERS OF CREDIT AND OTHER OFF-BALANCE SHEET ITEMS

The figures for this item would be the same as item #4. Credit unions do not have standby letters of credit or other significant off-balance sheet items.

ITEM #6

CLASSIFIED ASSETS AND NONPERFORMING ASSETS AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
6/30/85	.58
1984	.61
1983	.74
1982	.93
1981	.91
1980	1.03
1979	.96
1978	.77

For purposes of this report, nonperforming assets are considered to be all loans in excess of 6 months delinquent.

ITEM #7

CLASSIFIED AND NONPERFORMING ENERGY LOANS, AGRICULTURAL LOANS, INTERNATIONAL LOANS, AND REAL ESTATE DEVELOPMENT LOANS AND INVESTMENTS, EACH AS A PERCENTAGE OF PRIMARY CAPITAL

Credit unions are consumer oriented and their lending activities are concentrated primarily in consumer-type loans. There are no international loans or real estate development investments. We are not aware of any significant amount of energy loans or real estate development loans. We are beginning to experience some problems with credit unions in the farm belt whose fields of membership are dedicated primarily to the farm community.

Agriculture loans and real estate development loans are not separately identified on our call reports, but we will begin obtaining this information during the next call report period.

ITEM #8

PURCHASED FUNDS AND BROKERED DEPOSITS, EACH AS A PERCENTAGE OF TOTAL ASSETS

Year	Percentage
6/30/85	.4
1984	1.0
1983	.8
1982	.9
1981	1.9
1980	2.3
1979	4.8
1978	6.2
1977	5.3
1976	4.3
1975	3.9
1974	4.1
1973	3.7
1972	2.3
1971	2.3

The percentages listed above represent borrowed funds. There have been some isolated incidents of brokered funds received by credit unions, but this does not seem to be a widespread occurrence. Brokered funds activity was reported by credit unions for the first time on the December 1984 call reports, but the information was subsequently found to be inaccurate - overstated. The data reported would have resulted in a figure of less than .1 percent.

ITEM #9

NET INCOME AS A PERCENTAGE OF EQUITY CAPITAL AND NET INCOME AS A PERCENTAGE OF ASSETS

Year	Net Income to Capital	Net Income to Assets
6/30/85	16.32*	1.11*
1984	17.28	1.22
1983	13.30	.91
1982	14.12	1.02
1981	14.89	1.04
1980	8.02	.51
1979	13.04	.87
1978	17.61	1.10
1977	16.79	1.02
1976	17.60	1.11
1975	15.71	1.03
1974	17.64	1.23
1973	12.93	1.16
1972	13.03	1.20
1971	12.63	1.22

Net income is before reserve transfers.

The same definition of capital is applied here as in item #3.

*Annualized

ITEM #10

SUPPLEMENTAL INFORMATION

NUMBER AND TOTAL DEPOSITS (SHARES) OF PROBLEM CREDIT UNIONS AS A PERCENTAGE OF TOTAL INSURED CREDIT UNIONS

Year	Number as % of Total	Deposits as % of Total
6/30/85	4.9	4.0
1984	5.7	4.5
1983	7.1	5.8
1982	7.2	6.7
1981	6.9	5.2
1980	5.9	4.4
1979	5.8	4.8
1978	4.8	3.3
1977	4.0	1.4
1976	5.1	1.9

See item #1 for definition of problem credit unions.

ITEM #10

SUPPLEMENTAL INFORMATION

GENERAL DATA

Year	Number of Credit Unions	Number of Members	Assets (Millions)	Shares (Millions)
6/30/85	14,916	43,940,144	$106,785	$96,703
1984	15,193	43,356,240	$92,846	$84,254
1983	15,877	41,076,615	$81,961	$74,186
1982	16,435	39,298,832	$69,572	$62,976
1981	16,963	38,413,265	$64,490	$57,796
1980	17,350	36,856,813	$60,962	$54,732
1979	17,507	37,008,329	$54,928	$47,703
1978	17,121	34,739,247	$51,417	$44,119
1977	16,632	29,421,785	$43,451	$37,333
1976	16,276	26,297,210	$35,095	$30,354
1975	15,777	23,747,455	$28,814	$24,973
1974	15,146	21,068,652	$22,754	$19,562
1973	14,344	18,496,398	$18,902	$16,332
1972	14,023	16,615,748	$15,811	$13,843
1971	13,510	14,626,447	$12,508	$10,891

ITEM #10

SUPPLEMENTAL INFORMATION

ANNUAL GROWTH RATES FOR ASSETS AND SHARES

Year	Assets	Shares
6/30/85	30.0% *	29.6% *
1984	13.3%	13.6%
1983	17.8%	17.8%
1982	7.9%	9.0%
1981	5.8%	5.6%
1980	11.0%	14.7%
1979	6.8%	8.1%
1978	18.3%	18.2%
1977	23.8%	23.0%
1976	21.8%	21.5%
1975	26.6%	27.7%
1974	20.4%	19.8%
1973	19.5%	18.0%
1972	26.4%	27.1%

These figures are based on aggregte amounts in all federally insured credit unions and may be impacted by credit unions entering or leaving the federal share insurance system.

*Annualized

ITEM #10

SUPPLEMENTAL INFORMATION

NUMBER OF MAJOR PROBLEM CASE CREDIT UNIONS

Year	Number
6/30/85	50
1984	72
1983	113
1982	124
1981	114
1980	59
1979	30
1978	12
1977	9
1976	10
1975	5
1974	4
1973	20
1972	0
1971	0

These figures represent the number of operating credit unions with outstanding assistance from the National Credit Union Share Insurance Fund. These are the most severe problem cases and represent the highest degree of risk to the Insurance Fund.

○